SUPREME COURT, U. S.
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MICHAEL RODAK, JR

IN THE

Supreme Court of The United States

OCTOBER TERM, 1974

No. 74-960

GEORGE MITCHELL & ASSOCIATES, INC.,
Petitioner,

v.

TORBERT H. MACDONALD & SIDNEY R. YATES,
Respondent.

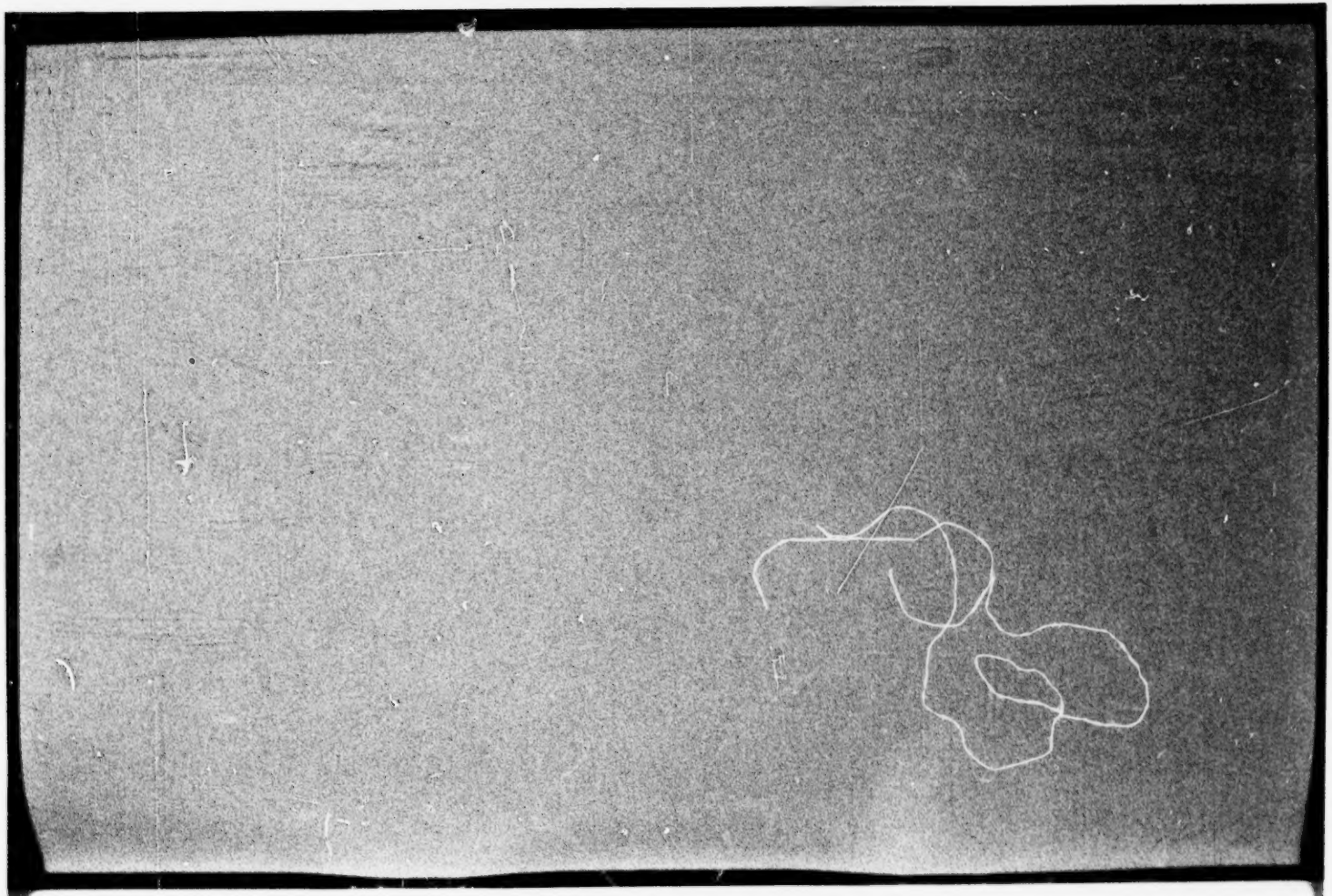
PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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The Petitioner, George Mitchell & Associates, Inc., (Mitchell) respectfully prays that a writ of certiorari issue to review the judgment and the opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this proceeding on September 19, 1974 and the orders denying rehearing issued December 2, 1974.

OPINION BELOW

The opinion of the Court of Appeals (Appendix A hereto) is not yet reported. The initial order of the Federal Power Commission (Appendix B hereto) and its order denying rehearing (Appendix C hereto) are reported at 49 FPC 424 (1973) and 49 FPC 1434 (1973), respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1974 (Appendix D hereto). A timely petition for rehearing was denied on December 2, 1974 (Appendix E hereto) and this petition for certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) (1970) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b) (1970).

QUESTIONS PRESENTED

1. Is the Federal Power Commission precluded from granting an independent producer special relief from an area rate order in the absence of evidence of that individual producer's costs and profits?

2. Does the Court's ruling that special relief from an area rate order may only be granted upon a showing of that individual producer's costs and profits, conflict with the opinions of this Court and the Fifth Circuit approving Federal Power Commission area rate orders?

STATUTORY PROVISIONS INVOLVED

Sections 4, 5 and 19(b) of the Natural Gas Act, 15 U.S.C. §§717c, 717d, 717r (1970) and §10(e) of the Administrative Procedure Act, 5 U.S.C. §706 (1970) are involved.

STATEMENT OF THE CASE

A. Background

The Federal Power Commission's (Commission) jurisdiction under the Natural Gas Act to regulate wellhead sales by producers of natural gas to interstate pipelines was established by this Court in 1954 in *Phillips Petroleum Company* v. *Wisconsin*.[1] In the wake of that decision, the FPC undertook the regulation of independent producer sales of natural gas on an individual company cost-of-service basis. In 1960, the Commission determined that individual cost-of-service regulation for producers was not well-suited to the producing industry and abandoned that approach. In lieu of the individual company cost-of-service approach, the Commission instituted a round of area rate proceedings to determine just and reasonable producer rates for major geographic producing areas on the basis of industry average costs and non-cost factors, a decision affirmed by this Court in *Phillips II*.[2]

This area rate concept of producer regulation was novel and, consequently, the Commission's first area rate decision presented a number of issues which had not been confronted previously.[3] The Commission was aware that the area rate levels it established may not be applicable or appropriate for all wellhead sales of natural gas from a particular region and that exceptional treatment might be required. The Commission did not fully define the circumstances which would permit exceptional treatment but provided that

> "any producer unwilling to accept a certificate at the appropriate ceiling will have an opportunity to show in the hearing on his certificate application the special circumstances which he believes warrant making an exception in his case in the public interest."[4]

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[1] 347 U.S. 672 (1954).

[2] *Wisconsin* v. *FPC*, 373 U.S. 294 (1963).

[3] *Permian Basin Area Rate Proceeding*, 34 FPC 159, 226 (1965).

[4] *Id.*

While indicating that there may be instances in which a producer's property could be unlawfully confiscated as a result of an area rate, the Commission did not limit special relief to such instances but noted also that

> "there may be other circumstances where a producer as a matter of law or in the public interest would be entitled to some relief."[5]

The Commission recognized that in the future

> "[T]here may, however, be some exceptional situations where abandonment could be shown to be detrimental to consumers, or where the producer could demonstrate that some other form of relief would best serve the interests of the public as well as his own."[6]

This Court affirmed the Commission's initial area rate pricing experiment in its entirety.[7] The Court noted specifically with reference to the special relief procedure that

> "the Commission quite reasonably believed that the terms of any exceptional relief should be developed as its experience with area regulation lengthens. Moreover, area regulation of producer prices is avowedly still experimental in its terms and uncertain in its ultimate consequences . . ."[8]

Supported by this Court's affirmance, the Commission thereafter undertook the setting of area rates in each other producing region and uniformly provided for a producer's right to seek special relief from area rate ceilings.[9]

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[5] *Id.*

[6] *Id.*

[7] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

[8] *Id.* at 772.

[9] *See Other Southwest Area Rate Proceedings*, 46 FPC 900 (1971), *aff'd Other Southwest Area Rate Case, Shell Oil Co.* v. *FPC*, 484 F.2d 469 (5th Cir. 1973); *Southern Louisiana Area Rate Proceeding*, 46 FPC 86 (1971), *aff'd Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974); *Rocky Mountain Area Rate Proceeding*, 46 FPC 68 (1971); *Texas Gulf Coast Area Rate Proceeding*, 45 FPC 674 (1971), *remanded for further consideration, Texas Gulf*

B. Proceeding Before The Commission

Mitchell filed on August 11, 1972 a petition for special relief from the area rate ceilings established by the Commission in the *Other Southwest Area Rate Proceeding.* The increased rate sought in excess of the area rate was contained in a renegotiated contract between Mitchell and an interstate pipeline-purchaser, Natural Gas Pipe Line Company of America (Natural). The contractual amendment obligated Mitchell (a) to undertake an extensive additional exploration and development program in the Boonesville Bend Field which would entail the acquisition and dedication by Mitchell to Natural of additional gas-producing acreage and (b) to extend the term of the original gas sales contract (which would have expired in 1977) for an additional 20-year period. In return for this additional consideration, Natural agreed to pay Mitchell 30¢ per Mcf plus a BTU adjustment with a continuation of the .25¢ dehydration allowance delivered from the Boonesville Bend Field through December 27, 1977 with a 1¢ per Mcf escalation every five years thereafter through the life of the contract. Absent these renegotiated contractual provisions, Mitchell had no obligation to drill any additional wells or to acquire and dedicate any additional acreage to Natural in the Boonesville Bend Field. Mitchell had, in fact, determined that substantial additional drilling in this area at the original contract rates would be uneconomic and consequently would not be undertaken, except whenever it might be necessary to protect the existing leases and to prevent drainage by other producers in adjacent fields.

The application for special relief was noticed and Associated Gas Distributors, (a group of over 50 East Coast gas distribution companies), Natural Gas Pipeline Com-

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Coast Area Natural Gas Rate Case, 159 U.S. App. D.C. 172, 487 F.2d 1043 (1973); *Area Rates for the Appalachian-Illinois Basin Areas*, 44 FPC 1112 (1970); *Hugoton-Anadarko Area Rate Proceeding*, 44 FPC 761 (1970), *aff'd People of the State of California* v. *FPC*, 466 F.2d 974 (9th Cir. 1972).

pany of America, Northern Illinois Gas Company, North Shore Gas Company and The Peoples Gas, Light and Coke Company intervened. Following the submission of sworn testimony by applicant's witnesses and a witness for the staff of the Federal Power Commission, the staff's attorney initiated informal settlement conferences. After these conferences, in which all parties participated, it was concluded that an adjudicatory hearing was not required as there were no disputed facts. Subsequently a settlement agreement which revised in part the relief sought in the petition for special relief was presented to the Commission and adopted in its entirety in Opinion Nos. 649 and 649A.

Under the Commission-approved settlement, Mitchell was authorized to receive an increase in the price of gas sold to Natural from the then applicable area ceiling price of 18.86¢ per Mcf to 30¢ per Mcf with an additional .25¢ per Mcf plant dehydration allowance. Pursuant to the settlement, Mitchell waived its right to receive a contractually authorized BTU adjustment. In addition, Mitchell agreed to expend in exploration and development activities in the Continental United States over the next five-year period, the sum of $16,496,847, over $3 million above the historical level of such expenditures for Mitchell. Mitchell also agreed to (a) undertake a drilling program of a minimum of 125 additional wells in the Boonesville Bend Field, and to sell the resultant production from all successful wells to Natural, (b) continue deliveries to Natural for the life of the field and (c) install additional field compression to maintain the deliverability of gas from the field. The practical impact of this drilling program, as demonstrated by the uncontroverted record evidence, is to double the deliverability life of the Boonesville Bend Field over the five-year period at an incremental cost increase to Natural of $.0031 per Mcf. In addition, Mitchell was also obligated to offer to Natural any gas which it develops in Texas within 25 miles of Natural's (or its

affiliates') gathering and transmission facilities if Natural is willing to purchase the gas at competitive rates. If Natural does not exercise its preferential right to purchase on gas developed within this corridor and for all other gas developed as a result of the expenditure of the $16,496,847,[10] Mitchell is required to make a good faith effort to offer any gas to the *interstate market* if such market is price competitive with the intrastate or local market.

In approving the settlement the Commission stated that it had made a full examination of the record evidence

> "to determine if the public interest is served by the grant of the special relief sought." App. B at 6.

The Commission also announced that this was the first opportunity it had to

> "express our views on the use of special relief procedures as a means of alleviating the natural gas shortage through expanded domestic exploration and development and in assessing the record here, we have sought to determine the justness and reasonableness of the proposed rates by testing them in the light of the cost and non-cost factors as directed by *Austral*."[11]

The Commission did examine various non-cost factors, namely, the supply-price demand relationship, capital formation within the producing industry, the consequences of its order upon the producing industry, and whether the order provides appropriate protection to the relevant present and future public interests, stating,

> "*We must decide our cases in the context of our duty to seek a reliable and adequate supply of gas at the lowest reasonable cost.*" App. B at 6-7 (emphasis in original).

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[10] To date over $15,000,000 has been expended by Mitchell in performance of its obligations.

[11] FPC Opinion No. 649, 49 FPC 424, 427 (1973).

Based on its determination of the costs to the public and the uncontroverted evidence that given the cost of the proposed drilling program and additional compression, Mitchell could not even recover its out-of-pocket expenses at the existing area rate ceilings, the Commission concluded that without special relief the gas-consuming public served by Natural would lose at least 37.1 Bcf of gas and perhaps a great deal more as a result of premature abandonment. Accordingly, the Commission determined, that the $0.0031 per Mcf increase experienced in Natural's rates if the special relief were permitted, was in the public interest.

On March 23, 1973, 28 days after the issuance of Opinion No. 649, Congressmen Torbert H. Macdonald and Sidney R. Yates, filed an untimely petition for leave to intervene and an application for rehearing raising at this juncture, their objections to the petition for special relief.

On June 25, 1973, the Commission denied applications for rehearing of its order noting that this was a case of first impression and that the granting of an application for special relief need not be restricted to solely an individual cost-of-service presentation. Moreover, the Commission noted the Fifth Circuit in *Placid Oil Co.* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), and *Shell Oil Co.* v. *FPC*, 484 F.2d 469 (5th Cir. 1973) had cited with approval the Commission opinion herein granting special relief provisions as a useful companion to the overall ratemaking methodology for establishing just and reasonable area rates.

C. The Decision Below

On the petition for review, the Court of Appeals for the District of Columbia Circuit rejected the tests applied by the Commission in determining that the unanimous settlement agreement was in the public interest, and concluded that the exclusive basis upon which the Commission could permit an individual producer to depart from its area

ceilings is upon a showing of the producer's individual costs. The Court stated that consideration must focus on individual costs

> "in order to ensure that the producer's profit margin is not thereby raised to an unreasonable level." App. A at 19.

REASONS FOR GRANTING THE WRIT

I. The Court's Decision Below Is In Direct Conflict With Opinions Of This Court And The 5th Circuit Approving The Commission's Use Of Its Ratemaking As A Functional Tool In Eliciting New Gas Supplies.

This Court has consistently held in the area rate cases that departures from cost-based pricing were not unreasonable and that the Commission was obliged to adopt a regulatory method that considered all "relevant public interests"[12] and was not limited to a regulatory formula which would exclude

> "as immaterial all but current or projected costs could not serve the consumer interests . . . ."[13]

Moreover, this Court has recognized the elasticity of the supply of gas and that

> "price can be employed by the Commission to encourage exploration and production."[14]

In this case, the Commission examined the costs of the expanded exploration program, the quantity of additional reserves to be dedicated to the interstate market and the cost impact upon the interstate pipeline and properly determined that the public interest would be served by granting the petition for special relief.

The decision below requiring the Commission to review applications for special relief from an area rate on the

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[12] *Permian* at 792.

[13] *Permian* at 815, *see also Mobil Oil* at 309.

[14] *Permian* at 796.

basis of the individual producer's overall costs and profits, encompassing activities in *all* producing areas, is in direct conflict with this Court's holdings and will severely restrict the Commission's efforts to structure a sound ratemaking methodology which is designed to elicit the dedication of needed natural gas reserves to the interstate market.

The Fifth Circuit, in affirming the Commission's area rate determinations for the Southern Louisiana area, noted with respect to this application for special relief that

> ". . . it is a comforting reassurance to a court that has demonstrated so many times its inability to review rate determinations with infallible omniscience to know that there are alternative methods by which producers who are unable to exist in the economic clime of the area rate ceilings may get administrative consideration of the merits of their claims . . . . The presence of these alternatives [special relief and the optional pricing procedure] should serve to alleviate any problems engendered by the area approach. They certainly provide great comfort to us in our role as a court compelled to review the area rate determinations, and furnish us with additional support for our decision today."[15]

The court specifically cited the Commission's decision approving Mitchell's application for special relief herein in support of its observation.

Subsequently, the Fifth Circuit had yet another opportunity to comment favorably on use of the provisions for special relief from area rate ceilings. In *Other Southwest Area Rate Case*, the Fifth Circuit affirmed the Commission's order and in doing so stated

> "In *SOLA-II*, Part V [the Placid Oil opinion], we examined several alternative channels of relief for a producer whose special circumstances warranted higher rates than the maximum allowed by the area rate

[15] *Placid Oil Co.* v. *FPC*, 483 F.2d 880, 913 (5th Cir. 1973), *aff'd Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974).

> proceeding . . . . Of course, all of those special relief procedures are equally applicable here. And there is a substantial indication that they are being exploited.'
>
> ' George Mitchell & Associates, Op: 649, 'Opinion and order granting special relief and terminating proceedings,' F.P.C. (Feb. 21, 1973) with such a proceeding granting special relief to a producer in OSWA [Other Southwest]. The readiness of FPC to entertain such petitions and the effectiveness with which they are processed bolsters the reassurance which we expressed in *SOLA-II*, Part VII [The Placid Oil opinion]." (Footnote in original text.)[16]

The Fifth Circuit's conclusion that the special relief provisions provide additional flexibility to the Commission in determining appropriate rates under special circumstances is in direct conflict with the D.C. Circuit's conclusion that special relief must be based solely on a cost-of-service analysis and profit level determination. The Court below, without any direct precedent, has severely impaired the Commission's ability to fashion rate relief tailored to elicit quantified volumes of additional gas supplies to interstate consumers. This Court has only recently affirmed the Commission's latitude in creating methods of regulation which give effect both to the Commission's responsibility to assure an adequate gas supply for interstate gas consumers and to do so at the lowest reasonable cost to those consumers.[17]

II. The Opinion Below Erroneously Constricts The Commission's Ability To Apply The Natural Gas Act Pragmatically To Elicit New Gas Supplies.

This is the first case to reach the Commission and the courts under the special relief provisions of the Commission's area rate orders. In determining that the special

[16] *Shell Oil Co.* v. *FPC*, 484 F.2d 469, 480 (5th Cir. 1973), *cert. denied*, 42 U.S.L.W. 3668 (U.S. June 17, 1974).

[17] *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974).

rate relief from the area rate ceilings which it approved in this case was in the public interest, the Commission gave practical meaning to the "end results" test of its rate-making authority. Thus it was able to determine here that the incremental costs to the producer of making available substantial additional Boonesville Bend Field natural gas reserves to the interstate market were in excess of the area rate ceiling.[18] It had before it here concrete evidence of a positive relationship between the rate increase sought from the area rate order and the additional exploratory effort that would be generated by the granting of such special relief. It was able on this record to establish the approximate quantity of additional gas supplies to be recovered as the result of its rate order. It could determine the actual cost impact of granting the relief here requested upon the consumers receiving these gas supplies. Finally, it also obtained a specific commitment of additional funds for exploratory efforts if the rate relief here requested were granted.

As this Court recognized in *Mobil Oil Corp.* v. *FPC*, against the background of a serious and growing shortage of natural gas, the Commission had discretion to approve contingent escalation and refund credit provisions *even though* it was unable to quantify a specific amount of additional gas supply that would be found and dedicated to interstate sales as the result of its order.[19] In this case, the Commission had before it a settlement directly linking additional exploratory and developmental effort to the special rate relief that was proposed; it had before it uncontroverted evidence as to the additional gas supply that would be forthcoming from the grant of special relief; and

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[18] The acquisition of additional acreage, drilling of additional wells, and the addition of compression facilities was estimated to double the deliverability life of gas reserves from the Boonesville Bend Field, by uncontroverted expert evidence.

[19] 417 U.S. 283.

it had an additional, albeit contingent,[20] commitment of gas to the interstate market if increased exploratory expenditures proved to be fruitful. In short, the end result of the rate relief here granted by the Commission, in terms of additional gas supplies and quantified impact upon gas consumers, was far less speculative than the impact of its area rate order approved in *Mobil*.

Mitchell submits that the Commission acted within the statutory framework and the Court of Appeals improperly reversed its Opinion Nos. 649 and 649A.

The Natural Gas Act to be effective must be interpreted and applied realistically within the ambit of the Commission's responsibility to assure an adequate gas supply at the lowest reasonable cost to gas consumers.[21] This Court has recently stated

> "The Act directs that all producer rates be just and reasonable *but it does not specify the means by which regulatory prescription is to be attained.* That every rate of every natural gas company must be just and reasonable *does not require that the cost of each company be ascertained and its rates fixed with respect to its own costs.*" *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 387 (1974) (emphasis added).

The decision below completely disregards these established precedents and provides that the Commission must use the individual cost-of-service in assessing a petition for special relief. Not only has the Court of Appeals stated that the Commission must employ a discarded ratemaking method for independent producer rates but it has also abrogated established precedent by substituting its judgment in the selection of a ratemaking method for that of the Commission.

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[20] Significantly, the option of securing additional supplies was vested in the interstate buyer who had first call on any additional reserves.

[21] *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959).

The Commission has consistently been granted broad discretion in determining the public convenience and necessity within the context of the factual circumstances existent in individual proceedings. This Court has given the Commission substantial latitude in determining whether rates are in the public interest. In *FPC* v. *Natural Gas Pipeline Co.,* this Court stated

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[22]

Several years later this Court affirmed in *Wisconsin* v. *FPC* (already cited p. 3) the Commission's decision to abandon the individual cost-of-service method of fixing rates and substitute area ratemaking. It noted

> " . . . to declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates. . ."[23]

The enunciation of this ratemaking principle was wholly consistent with this Court's prior views in both *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575 (1942) and *Colorado Interstate Gas Co.* v. *FPC,* 324 U.S. 581 (1945), and reaffirmed the principle which had been clearly stated in the *Hope* case:

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[22] 315 U.S. at 586.

[23] 373 U.S. at 309.

> "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."[24]

To retain its viability, the courts have provided that the Natural Gas Act must be applied within the context of existing facts and not under only hypothetical conditions. The critical consideration is the end result of the Commission's order on natural gas consumers. As this Court stated

> "It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach the result may contain infirmities is not then important."[25]

This Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) enunciated in addition to the "end result test" the following broad principles which govern the review of the Commission's ratemaking order.

> "[The] responsibilities of a reviewing court are essentially three. First, it must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interest, both existing and foreseeable. The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly

[24] 320 U.S. at 602.

[25] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

> to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors."[26]

Mitchell submits that the Commission opinion below satisfies each of these criteria as well as the "end result" test noted earlier and therefore urges that this Court grant this petition for certiorari so as to correct the erroneous decision of the Court of Appeals.

III. The Commission's Opinion Nos. 649 And 649A Are A Valid Exercise Of Its Statutory Authority And Must Be Upheld.

In assessing the application for special relief, the Commission and all parties to the proceeding were provided with an evidentiary presentation which sets forth all of the relevant data required by the Commission to make an informed determination that the special relief sought was in the public interest.

The Commission's expertise in natural gas pricing matters has been acknowledged by all reviewing courts. In fact, in the landmark case[27] in which this Court approved the concept of special relief, it also delineated the nature and extent of a Court's review of the Commission's decisions. The court noted that

> "[T]he Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production."[28]

An analysis of relevant precedents reveals that the Commission acted within the bounds of its statutory dis-

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[26] 390 U.S. at 791-92.

[27] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968)

[28] *Id.* at 797.

cretion.[29] As noted earlier, the established precedents provide the Commission wide latitude in hearing applications for special relief. *Permian,* by its express acceptance of the Commission's contention that there were other, unenumerated circumstances besides an inability to meet out-of-pocket expenses justifying such relief, specifically authorizes the Commission to explore additional approaches to the pricing problem. All area rate decisions have systematically excluded individual cost-of-service presentations and have recognized the propriety of using average costs as a benchmark and then adding non-cost factors to provide the necessary incentives for additional exploration and development. Such an approach was clearly sanctioned by the Supreme Court's *Permian* decision which insisted that the Commission be given every reasonable opportunity to formulate appropriate methods of regulation and noted that a method wholly dependent on current or projected costs could not properly serve the consumer interest.[30] In its Notice of Rulemaking, Docket No. R-441 (issued April 6, 1972), as noted in Opinion No. 649 at page 1, the Commission announced its intention to apply the standards underlying its utilization of non-cost factors in area rates to petitions for special relief.

The Supreme Court's decision in *Permian* precludes any assertion that deviation from area rates be supported by an evidentiary presentation of *individual* company cost-of-service. The starting point is the *City of Detroit* decision,[31] which limited a pipeline's rates for producing properties to rates arrived at under a conventional rate-base method.

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[29] The Court of Appeals for the Fifth Circuit has recently cited with approval the concept of allowing the producers to seek relief from the area rates by filing petitions for special relief, *Placid Oil Co.*, 483 F.2d 880 (5th Cir. 1973); *see also Shell Oil Co.* v. *FPC*, 484 F.2d 469 (5th Cir. 1973).

[30] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *see also Moss* v. *FPC*, U.S. App. D.C. , 502 F.2d 461 (1974).

[31] *City of Detroit, Michigan* v. *FPC*, 97 U.S. App. D.C. 260, 230 F.2d 810 (1955), *cert. denied*, 352 U.S. 829 (1956).

Any allowance in excess required independent justification. Subsequently, the *City of Chicago* eliminated the requirement for a pipeline cost-of-service to establish rates for pipeline-owned production. It approved rates based upon composite producer costs totally unrelated to pipeline costs, because area rates

> "are essentially rates based on composite cost-of-service for all producers in a given geographic area [and] . . . remain at the heart of the regulatory system."[32]

In its *SOLA II* opinion, the Fifth Circuit sanctions the Commission's de-emphasis of the use of unit costing as a basis for area rate regulation, quoting the Commission's conclusion that the seeming precision of the mathematical calculations has given the appearance of certitude which in fact does not exist.[33] This Court affirmed the Fifth Circuit's findings in *Mobil* noting that it had approved the Commission's departure from cost-based pricing in *Permian.*

Although a complete individual cost-of-service presentation on all of Mitchell's jurisdictional natural gas operations was not submitted, the record presented to the Commission was not devoid of cost data. The record contains uncontroverted evidence as to the actual costs experienced and those anticipated in fulfillment of the exploration, development and compression programs by Mitchell in the Boonesville Bend Field. The unchallenged evidence demonstrated that the dry hole and completion cost of a well in this area for the first six months of 1972 was $54,620 and $70,735, respectively. Mitchell's witness Thompson further projected that these costs would escalate to $60,000 for a dry hole and $80,000 for a completed well within the

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[32] *City of Chicago, Illinois* v. *FPC,* 147 U.S. App. D.C. 312, 332, 458 F.2d 731, 751 (1971), *cert. denied,* 405 U.S. 1074 (1972).

[33] *Placid Oil Co.* v. *FPC,* 483 F.2d 880, 899 n.19 (5th Cir. 1973).

next five years. Leasehold acquisition costs would approximate $5,300 per well.

Based on these data, witness Thompson estimated that the cost of drilling 125 additional wells would be in excess of $8.9 million. The necessary compression required to maintain wellhead deliverability would increase Mitchell's expense by an additional $2 million. In addition to these funds that would be expended, the Commission *via* the settlement extracted a commitment from Mitchell to expend $7.5 million to explore and develop reserves in the Continental United States.

The Commission concluded in reviewing the overall settlement that

> "Mitchell was agreeing to the risk of $18,496,847 over five years in exploration, development, and production funds in return for a rate increase which generated $7,733,810 over the same time span. If Mitchell's program is successful, it might realize $3,000,000 in excess of area rate revenues, but if unsuccessful, it might lose $11,000,000. We afforded Mitchell no protection against the down-side risk, but at the same time we required a $3,000,000 investment (over and above Mitchell's normal investment level) in domestic exploration and development, even if Mitchell sustains a loss on the Boonesville Bend project." App. C at 9.

The Court below ignored the specific cost evidence supporting the Commission's findings and instead insisted that the Commission's determination must be predicated solely upon an individual cost-of-service presentation.

The record reflects that the impact of the Commission's order is an increase of .0031¢ to the natural gas consumer plus a commitment for the expenditures of substantial additional funds for exploration and development of gas reserves, with a potential of 37.1 Bcf. The "end result" as determined by the Commission is within the public interest.

IV. The Court Erred In Substituting Its Determination For A Ratemaking Method In Lieu Of The One Selected By The Commission.

This Court in promulgating the criteria governing the scope of judicial review, noted earlier, has provided a definitive statement as to the reviewing court's responsibility.

> "The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors."[34]

The Court below has completely disregarded the factors considered and the formula employed by the Commission and substituted its judgment for that of the Commission and determined that *only* individual cost considerations can trigger the special relief provisions of the Commission's area rate orders. The Commission on the other hand in its first case involving a petition for special relief elected to examine a variety of cost and non-cost factors, which were designed to elicit additional natural gas supplies for the interstate market.

The Commission on the basis of the evidentiary material presented was provided the costs involved in undertaking the required additional development and compression programs and determined that it was uneconomic for Mitchell to undertake this program at the existing rates. The evidence also showed the deliverability life that could be added and additional gas supplies delivered to the interstate pipeline company purchaser as a result of this program. The Commission through its staff and the other parties to the proceeding was able to extract a commitment from Mitchell to expend $16,496,847, more than $3,000,000 above the historical level of expenditures in the continental United States within a five-year period.

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[34] *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1974). *See also Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974).

The additional gas supply that could be made available to the gas consumer would be available only if the special relief was granted by the Commission. In this case the Commission has provided a reasoned explanation of the approximate amount of additional gas reserves that would be forthcoming if it granted the relief requested and has concluded that it is in the public interest for the interstate consumers to bear the resulting *de minimus* increase in the price of this essential fuel that will flow from its action.

To require an individual cost-of-service presentation as the sole criterion upon which an application for special relief can be granted, the Court below has, in the first special relief case to reach the courts, unduly restricted the Commission's discretionary authority which traditionally provides that it may employ any formula or combination of formulae it wishes and is free to make pragmatic adjustments which may be called for by particular circumstances.[35] This restriction runs contrary to the court's suggestion to the Commission to develop new methods for developing additional gas supply at just and reasonable rates and to assess the consequences of its order.[36]

V. Conclusion

The precedent established by the decision of the Court below nullifies the Commission's use of its authority to grant special relief where necessary to elicit additional gas supplies for interstate consumers. The opinion also is in direct conflict with the decisions of this Court in *Permian* and *Mobil* and the decisions of the Court of Appeals for the Fifth Circuit in *Austral, Placid* and *Shell.* Given the importance of the questions presented and the urgent need to

[35] *FPC* v. *Louisiana Power and Light Co.*, 406 U.S. 621 (1972); *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

[36] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *see also Moss* v. *FPC*. . U.S. App. D.C. , 502 F.2d 461 (1974); *Texas Gulf Coast Area Rate Cases*, 159 U.S. App. D.C. 172, 487 F.2d 1043 (1973).

resolve the conflicts question, this Court should exercise its reviewing authority.

WHEREFORE, petitioner respectfully prays that a writ of certiorari be granted.

Respectfully submitted,

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United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 73-1715

TORBERT H. MACDONALD and SIDNEY R. YATES,
PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

GEORGE MITCHELL & ASSOCIATES, INC.,
NORTHERN ILLINOIS GAS COMPANY,
NATURAL GAS PIPELINE COMPANY OF AMERICA
and AMERICAN PUBLIC GAS ASSOCIATION,
INTERVENORS

Petition to Review Orders of the
Federal Power Commission

Decided September 19, 1974

Morton L. Simons, with whom *Barbara M. Simons* was on the brief, for petitioners.

John H. Burnes, Jr., Attorney, Federal Power Commission, with whom *Leo E. Forquer*, General Counsel,

and *George W. McHenry, Jr.*, Solicitor, Federal Power Commission, were on the brief, for respondent.

Homer J. Penn for intervenor George Mitchell & Associates, Inc.

J. Stanley Stroud was on the brief for intervenor Northern Illinois Gas Company.

Paul E. Goldstein and *Paul W. Mallory* were on the brief for intervenor Natural Gas Pipeline Company of America.

Charles F. Wheatley, Jr. entered an appearance for intervenor American Public Gas Association.

Before WRIGHT and MACKINNON, *Circuit Judges*, and JAMESON,* *Senior District Judge*.

Opinion for the court filed by *Circuit Judge* WRIGHT.

Concurring opinion filed by *Circuit Judge* MACKINNON.

WRIGHT, *Circuit Judge*: Petitioner congressmen challenge orders of the Federal Power Commission [1] permitting a natural gas producer, George Mitchell & Associates, to increase its rates for gas sold pursuant to a 1954 contract in interstate commerce to a level about 65 per cent above that which other producers in Mitchell's production area may charge under the Commission's recently established Other Southwest Area rates.[2] Since

* Of the United States District Court for the District of Montana, sitting by designation pursuant to 28 U.S.C. § 294(d) (1970).

[1] Opinion No. 649, Feb. 21, 1973, Joint Appendix Vol. I at 10; Opinion No. 649-A Denying Rehearing, June 25, 1973, JA Vol. I at 62.

[2] Petitioner Congressman Macdonald is a member of the House Committee on Interstate and Foreign Commerce and is chairman of that Committee's Subcommittee on Commerce

the Commission justified its grant of "special relief" to Mitchell from the area rate by Mitchell's commitment to invest a certain level of funds in further gas exploration and production, this case requires us to exercise again our responsibility to review the Commission's efforts to respond to the natural gas shortage which all agree now confronts our nation. We recognize the broad discretion which has been entrusted to the Commission "to devise methods of [natural gas] regulation capable of equitably reconciling diverse and conflicting interests," *Mobil Oil Corp.* v. *FPC*, —— U.S. ——, ——, 42 U.S. L. WEEK 4842, 4856 (June 10, 1974), and that this discretion must be given particular respect "in this time of acute energy shortage." *Id.* However, the Supreme Court this year reaffirmed that the purposes of the Natural Gas Act, including that of protecting consumers from prices which are forced above a just and reasonable level by the market power of natural gas suppliers, impose limits on this discretion.[3] And we cannot say on the

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and Finance. Petitioner Congressman Yates represents constituents served by the gas for which the rate increase was approved and himself uses this gas. Inasmuch as Congressman Macdonald is not directly and personally aggrieved by the orders, there may be some question concerning his standing to bring this appeal. However, this issue was not raised by the Government and inasmuch as Congressman Yates is clearly aggrieved we need not reach it.

The congressmen petitioned to intervene in the Commission's consideration of the rate increase in order to obtain a rehearing of the Commission's initial order approving the increase. The Commission granted the intervention motion but denied the rehearing. Opinion No. 649-A, *supra* note 1, JA Vol. I at 62.

[3] *Mobil Oil Corp.* v. *FPC*, —— U.S. ——, ——, 42 U.S. L. WEEK 4842, 4849 (June 10, 1974); *FPC* v. *Texaco, Inc.*, —— U.S. ——, ——, 42 U.S. L .WEEK 4867, 4872 (June 10, 1974).

basis of the record before us that the orders here challenged do not constitute a transgression of those limits.[4]

I

The facts of this case take on greater meaning in the context of the history of federal regulation of natural gas producers. In the first several years after the Supreme Court held the Federal Power Commission to have a responsibility under the Natural Gas Act to regulate gas producers as well as pipelines,[5] the Commission evaluated the justness and reasonableness[6] of a producer's rates by attempting to determine the producer's individual costs, including of course its capital costs, and adding thereto a fair profit return on its investments.[7] In 1960, however, the Commission announced that it would divide the major gas producing regions in the United States into several discrete areas and would initiate proceedings to establish for each of these areas ceilings up to which it would approve producer charges as just and reasonable and above which it would not.[8]

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[4] In addition to attacking the substantive adequacy of the orders approving the rate increase, petitioners contend the Commission violated several of its own regulations in the course of the proceedings which produced these orders. *See* brief for petitioners at 22-24. Given our view of the substantive attack on the orders, it is not necessary to reach consideration of the alleged procedural defects.

[5] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

[6] Under § 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a) (1970), the Commission may at any time conduct an investigation into whether a given rate is "just and reasonable." *See also* 15 U.S.C. § 717c(e) (1970).

[7] *See City of Detroit* v. *FPC*, 97 U.S.App.D.C. 260, 263, 230 F.2d 810, 813 (1955), *cert. denied*, 352 U.S. 829 (1956); Breyer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers*, 86 HARV. L. REV. 941, 952-953 (1973).

[8] *See Statement of General Policy*, No. 61-1, 24 FPC 818 (1960).

In the ensuing area rate proceedings, these price ceilings were fixed by reference to average area-wide costs. This meant that low-cost producers would be able to charge rates appreciably above their individual costs and that high cost producers would be limited to rates which would not permit them to obtain a full fair return on their investments or perhaps even to recoup unsuccessful investment costs.

However, in its first area rate decision, *Permian Basin Area Rate Proceeding*, 34 FPC 159, 225-226 (1965), the Commission made clear that the area ceilings were not to be ignored whenever a showing was made of inordinate producer costs. The Commission declared it would grant relief from the ceilings only in more limited special circumstances such as "where a producer who has contracted for an above-ceiling price can show that his out-of-pocket expenses in connection with the operation of a particular well are greater than the revenues under the applicable area price." 34 FPC at 226. The Commission stated that there might be other circumstances warranting special relief, but it did not elaborate on what they might be. The Supreme Court approved the Commission's area rate policy as applied in the Permian Basin Area, specifically finding the provisions for special relief to be adequate. *Permian Basin Area Rate Cases*, 390 U.S. 747, 770-773 (1968). In subsequent decisions establishing rates for the other gas producing areas, including that for the Other Southwest Area,[9] the Commission provided that special relief from the area

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[9] *Other Southwest Area Rate Proceeding*, 46 FPC 900, 920 (1970), *affirmed*, 5 Cir., 484 F.2d 469 (1973), *cert. denied*, —— U.S. ——, 42 U.S. L. WEEK 3688 (June 18, 1974).

rates could be obtained in accordance with its *Permian Basin* precedent.[10]

By October 1971 when the order establishing rates in the Other Southwest Area was entered, the seriousness of our natural gas shortage had become evident to the Commission. In 1969 the Commission had instituted proceedings to reconsider in light of supply shortages the rates which it fixed for the Southern Louisiana Area in 1968.[11] The result of this reconsideration was a 1971 order increasing the ceiling rates for this area and providing incentives for commitment of additional gas to the interstate market.[12] The Commission's 1970 *Hugoton-Anadarko* [13] and its 1971 *Texas Gulf Coast* [14] rate decisions also both provided for increased rate incentives in response to the "present critical shortage of all forms of energy in the United States and the anticipated rapid growth of demand for natural gas." [15] As would be expected, the Commission set the Other Southwest Area rates as well after full consideration of the gas shortage. The Commission stated:

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[10] The special relief provisions have been codified for each area. For the Other Southwest Area, codification is at 18 C.F.R. § 154.109a(e) (1973).

[11] 41 FPC 378 (1969); 42 FPC 1110 (1969).

[12] *Southern Louisiana Area Rate Proceeding*, 46 FPC 86 (1971), *affirmed, sub nom. Placid Oil Co.* v. *FPC*, 5 Cir., 483 F.2d 880 (1973), *affirmed, sub nom. Mobil Oil Corp.* v. *FPC*, —— U.S. ——, 42 U.S. L. WEEK 4842 (June 10, 1974).

[13] 44 FPC 761, 781-783 (1970), *affirmed, sub nom. State of California* v. *FPC*, 9 Cir., 466 F.2d 974 (1972).

[14] 45 FPC 674, 687-689, 709-711 (1970), *reversed, sub nom. Public Service Com'n* v. *FPC*, 159 U.S.App.D.C. 172, 487 F.2d 1043 (1973), *vacated*, —— U.S. ——, 42 U.S. L. WEEK 3686 (June 18, 1974).

[15] *Id.* at 709.

> While we cannot expect that this area will be able to supply the potential demand upon it, it is important that its potential be fully utilized in this time of national need for all available gas.
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> • • • • • • •
>
> The prices established herein provide incentives, however, to the producers in this marginal area to find gas and dedicate it to interstate commerce. The prices established will enable the interstate market to compete in price with the present and potential intrastate buyers in the area.

46 FPC 900, 910-911, 911-912 (1971). As noted by the Fifth Circuit in approving the Other Southwest Area rate decision,[16] the Commission used average cost levels as its major point of reference but also considered supply and demand imbalance and existing inter- and intrastate price levels in establishing ceiling prices which it judged would provide adequate exploratory incentives.[17] It is from these Other Southwest Area ceiling prices, established in response to the natural gas shortage, that George Mitchell & Associates sought to obtain "special relief."

Mitchell filed its special relief petition less than a year after the Other Southwest Area decision. Under the established area rates Mitchell could sell gas produced from its Wise County region wells pursuant to a 1954 contract with Natural Gas Pipeline Company at 18.859¢ per Mcf.[18] It requested permission to sell this gas at

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[16] *In re Other Southwest Area Rate Case (OSWA I)*, 5 Cir., 484 F.2d 469, 475-476 (1973).

[17] 46 FPC 900, 912 (1971).

[18] The rates for gathered gas produced in the Other Southwest sub-area of which Wise County is a part pursuant to contracts dated before Oct. 1, 1968 is 19.7¢ per Mcf. *See* note 19 *infra*. The rate for ungathered gas in this sub-area, Texas District 9, is 1.5¢ lower, 18.2¢ per Mcf. 46 FPC 900, 921 & n.2

30.25¢ per Mcf. In support of its request Mitchell did not argue that the costs of its Wise County area operations are significantly greater than the average costs of gas production in its district of the Other Southwest Area.[19] Indeed it did not offer any evidence on its costs, or on the profitableness of its wells at the rates it was then charging.[20] Rather Mitchell requested the sharply above ceiling rate in return for its promise to undertake additional exploration in the Wise County area.

After a prehearing conference had been commenced and testimony had been placed on the record, a settlement proposal agreed to by the Commission staff and by Natural was submitted by Mitchell to the Commission for its consideration. Two months later the Commission approved the settlement by a two to one vote, there be-

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(1971). Mitchell sells a portion of ungathered gas as well as a portion of gathered gas. The Commission computed the 18.859¢ per Mcf figure taking into account these proportions. The rate for gathered gas produced in Texas District 9 pursuant to a contract dated after Oct. 1, 1968 was fixed at 24¢ per Mcf, *id.* at 914-915; it is 1.5¢ lower if the gas is ungathered, *id.* at 919. The Commission apparently assumed that, because the contract between Mitchell and Natural was dated in 1954, any new well gas sold to Natural by Mitchell under an amendment to their contract would be limited by the lower 19.7¢ and 18.2¢ ceilings. *See* JA Vol. I at 20.

[19] The Other Southwest Area is subdivided into several districts or sub-areas. This subdivision is necessary because the Other Southwest Area, unlike the other major production areas, is not homogeneous in its geology and markets. *See* 46 FPC 900, 907 (1971).

[20] Before its request to increase its rates to 30.25¢ per Mcf Mitchell was charging less under its contract with Natural than the area ceilings. Mitchell's pre-request charge was 17.625¢ per Mcf.

ing at the time two vacancies on the five-member Commission.[21]

The settlement reflected closely Mitchell's request for special relief. Mitchell was permitted to charge 30.25¢ per Mcf both for its old flowing gas and for new gas which it had not yet discovered and committed to interstate commerce. Mitchell agreed to drill at least 125 additional wells in the Wise County region covered in the contract between Mitchell and Natural. It agreed to sell in interstate commerce all the gas obtained from such additional drilling to Natural. Mitchell also agreed to expend $16,496,847 on gas or oil exploration within the continental United States in the five years from 1973 through 1977. This $16.5 million commitment is inclusive of the cost of drilling the new wells in the Wise County region.[22] It is estimated that the Wise County

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[21] We are not influenced by Natural's acquiescence in the settlement agreement. As stated by Chairman Nassikas in dissenting from the Commission's order below:

> Natural has neither the incentive to bargain for the lowest reasonable price to the consumer nor the power to do so. Natural can flow-through any increase in its purchased gas costs to its customers. When a pipeline is in curtailment, as Natural is, that buyer has little bargaining leverage. * * * It is difficult to conceive of any "arms-length bargaining" under these circumstances which only adds a greater responsibility to the Commission to examine the justness and reasonableness of the proposed rate.

JA Vol. I at 36.

[22] Mitchell did not agree to expend in the next five years $16.5 million more than it had theretofore planned to spend or than it had invested in gas and oil exploration during the previous five-year period. In 1972 Mitchell expended $7 million in exploratory efforts. In 1971 $3.5 million was spent. JA Vol. II at 37. The $16.5 million five-year figure is, of course, equivalent to only $3.3 million annually.

drilling will cost close to $9 million. Mitchell agreed to offer to sell to Natural at competitive rates all gas which it discovered in drilling outside the Wise County contract area but within 25 miles of Natural's pipeline in the State of Texas. If Natural fails to accept such an offer, Mitchell must make an effort to sell the gas in the interstate market at a price competitive with the intrastate or local market rate. Mitchell, however, has no obligation to expend any of the $16.5 million not used in drilling the 125 wells in the contract region—an estimated $7.5 million residual—in gas exploration close to the Natural pipeline, and gas discovered outside 25 miles from the pipeline need not even be offered to the interstate market.

The two-member Commission majority set forth a bareboned rationale for approval of the settlement. It stressed that, although much evidence indicated the existence of major amounts of untapped gas in the Wise County area, Mitchell had been drilling in the area at a rapidly declining rate. The Commission cited studies which predicted that if no increase in drilling occurred in this region there would be in the years from 1973 to 1977 significant decreases in the gas which could be delivered to Natural from the region. The Commission reasoned that if Natural were forced to obtain its gas elsewhere its ultimate consumers would suffer because of the high price of alternative sources of gas. The Commission explained the hesitancy of Mitchell to locate and produce in the Wise County region by Mitchell's inability in five years to recoup at the rate it could charge under the area ceiling the money it would have to expend in such location and production efforts. The Commission asserted that the 30.25¢ per Mcf rate requested by Mitchell for its sale of both old and new gas would be lower than any price which Natural could obtain from alternative

sources [23] and would not give Mitchell any "excessive profit returns." [24]

The Commission majority based its statement that Mitchell would not obtain excessive returns from the settlement on a computation which, though disputed by dissenting Chairman Nassikas and by petitioners, indicated that Mitchell in five years would obtain only $3 million in revenues from the rate increase above those funds which it would have to expend in drilling and running the wells.[25] The Commission did not consider the

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[23] Dissenting Chairman Nassikas challenged the Commission's reasoning on this point. The Commission compared the 30.25¢ per Mcf rate with a 33.6¢ per Mcf rate paid by Natural for limited term purchases of intrastate gas and with the costs of nonconventional sources such as liquefied natural gas. JA Vol. I at 19. Chairman Nassikas stressed that the incremental price of the gas expected to be produced by the 125 wells in five years would actually be 50.4¢ per Mcf, rather than 30.25¢, because the price increases on the old flowing gas are really costs to the consumers of the new gas which would not have to be paid if this gas were obtained from an alternative source. JA Vol. I at 30. If less gas than expected is found by drilling the 125 wells, then the incremental gas which is found would, of course, be even more costly per Mcf. Chairman Nassikas compared the 50.4¢ rate with what was then the average price for intrastate gas from the region around Natural's pipeline—35¢. *See* JA Vol. II at 14. Mitchell argues to this court, however, that the short-term sale price for intrastate gas available to Natural has escalated to 50¢ per Mcf (brief of intervenor Mitchell at 22), and the Commission in its order denying rehearing stressed that when the price increases on the old flowing gas are spread beyond five years over the productive life of the new wells the incremental cost of the new gas is reduced to 33¢ to 36¢ per Mcf. JA Vol. I at 71.

[24] JA Vol. I at 23.

[25] All parties agreed that, in addition to the almost $9 million estimated to be necessary to drill the 125 wells, Mitchell would be required to expend $2 million over the five-year

$3 million to be "excessive" because Mitchell was committed to expending in gas or oil exploration $7.5 million beyond that which it would have to expend in the Wise County region on the 125 new wells.[26]

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period for the compression needed to maintain the Wise County field at its present level of deliverability. The Commission staff originally calculated that the rate increase and new Wise County region drilling would yield extra revenues of $18.7 million to Mitchell. JA Vol. II at 110. The staff thus submitted an exhibit indicating that Mitchell would obtain extra estimated profits of $7.7 million from the new drilling ($18.7 million minus $9 million minus $2 million). *Id.* However, after Mitchell objected to this $7.7 million figure at a settlement conference, it was reduced to $3 million, allegedly to take into account *ad valorem* and severance taxes and an allocation of general corporate overhead. Noting that the taxes and corporate overhead could not account for a $4.7 million reduction, Chairman Nassikas found the record inadequate to support the $3 million rather than $7.7 million figure. JA Vol. I at 29 & n.10.

Petitioners question even the $7.7 million figure. They point out that Mitchell's offer of settlement states that 30 Bcf per year rather than the 21 Bcf per year used in the Commission's calculation will be eligible for the 30.25¢ rate, and that this higher amount would yield extra gross revenues of $24.7 million rather than $18.7 million to Mitchell over the five-year period. *See* brief for petitioners at 8 *and* JA Vol. II at 93.

[26] The Commission also stated that Mitchell risked an investment of $11 million in order to obtain a possible $3 million profit. The $11 million figure equals the $9 million thought necessary to drill the 125 new wells plus $2 million required to provide for the compression to maintain the present deliverability of the Wise County region. *See* note 25 *supra*. The risk is that of finding no gas from the drilling. This is a risk which must have been minimal if the unquestioned studies in the record which "reflect that there are substantial quantities of gas in place underlying the Mitchell acreage" are to be given the respect reposed in them by the Commission in stressing the importance of encouraging further development of the field. Opinion No. 649, *supra* note 1,

The Commission, however, had no evidence before it on how Mitchell's past costs and profit margins at the rates it had theretofore been charging compared with those of other producers in the Other Southwest Area. There was thus no way in which the Commission could determine from the record of this case what Mitchell's overall profit margin in the Wise County region would be under the 30.25¢ per Mcf rate. The disputed $3 million figure represents only an incremental profit which will derive from the settlement agreement. Further-

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JA Vol. I at 10, 19. And it is a risk which surely has not materialized; Mitchell reported at oral argument that thus far it has in fact been even somewhat more successful in its drilling efforts than was anticipated.

The Commission's risk argument was in any case completely deflated by the dissent of Chairman Nassikas. He pointed out that, even if Mitchell's drilling was completely unsuccessful, the rate increase on the gas flowing from the old wells would yield the producer $7.6 million in additional revenues. He also emphasized that the costs of dry holes would be less than the costs of successful wells. He cited testimony indicating Mitchell would need to expend only $7.5 million for drilling 125 dry holes. JA Vol. I at 32 & n.24. Mitchell thus would obtain revenues from the rate increase sufficient to pay for the new Wise County region drilling even if that drilling proved completely unsuccessful.

To be sure, Mitchell would still be committed to investing $9 million more over a five-year period in oil or gas exploration. But this investment can be made where Mitchell believes the chances of discovery of oil or gas are best, and per annum it is substantially less than the exploration investment Mitchell has made over the past several years. *See* note 22 *supra*. The Commission came close to suggesting at oral argument that any money reinvested in gas exploration should not be considered profit. Such a suggestion would, of course, be specious. Money placed in a capital investment is not necessarily lost to the investor; Mitchell, for example, will own any wells which it drills and will be entitled to a fair return on their costs. Old profits obtained from consumers provide the capital for new profits.

more, as stressed by dissenting Chairman Nassikas, in computing even this incremental profit the Commission failed to consider any revenues Mitchell can expect to obtain beyond the five-year period in which it is committed to drilling the 125 wells. Chairman Nassikas, using present value accounting and the best though admittedly inadequate data on Mitchell, computed that if these revenues are acknowledged Mitchell could expect even under the area rates to earn a handsome 20 per cent return on its exploration investment.[27] Chairman Nassikas urged remand of the proceeding for a further hearing before an administrative law judge to develop a record on Mitchell's costs and profit margins. He also argued that the Commission should at least have required all extra revenues beyond those obtainable with area rates to be reinvested in exploration for gas which would have to be dedicated to the interstate market.[28]

II

We cannot agree with the Commission that the Supreme Court's recent decision in *Mobil Oil Corp.* v. *FPC*, *supra*, constrains us to approve the Commission's grant of special relief to Mitchell on the evidentiary record before it. The Commission's action in the instant case goes a significant step beyond that which was given approval in *Mobil Oil*. As explained above at pages 6-7, the Commission has attempted to address the gas shortage by developing area rates which include not only an average area cost base, but also noncost incentives for new gas exploration and production. *Mobil Oil* was an affirmance of the Commission's development of such area rates in the Southern Louisiana Area. Wise County is part of

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[27] JA Vol. I at 33-34. Chairman Nassikas assumed in computing the 20% return that Mitchell would obtain a 100% working interest in the wells it drilled.

[28] JA Vol. I at 34-36.

the Other Southwest Area, the rate structure for which was set by the Commission to provide adequate incentives for production in light of the gas shortage. The Other Southwest Area Rate structure was approved in *In re Other Southwest Area Rate Case (OSWA I)*, 5 Cir., 484 F.2d 469 (1973), *cert. denied*, —— U.S. ——, 42 U.S. L. WEEK 3688 (June 18, 1974). Mitchell obtained a special exemption from the Other Southwest Area incentive rate ceilings without developing any evidentiary record to compare its costs and profit margins with the average costs and profit margins in the Other Southwest Area. We cannot conclude under the standards of appellate review of Commission orders set forth in *Permian Basin Area Rate Cases, supra*, and reaffirmed in *Mobil Oil*, that the Commission acted within its discretion in taking this additional step on the record before it.

The *Mobil Oil* Court focused upon three criteria of judicial review articulated in *Permian Basin*:

> First, [the reviewing court] must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable. The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Permian Basin Area Rate Cases, supra, 390 U.S. at 791-792, *quoted in Mobil Oil Corp.* v. *FPC, supra,* —— U.S. at ——, 42 U.S. L. WEEK at 4849. The Supreme Court in *Mobil Oil* made clear that Courts of Appeals rather than itself have the major responsibility in applying these standards of review, especially that of determining whether substantial evidence supports each of the Commission's findings.[29] "Whether on the record as a whole there is substantial evidence to support agency findings is a question which Congress has placed in the keeping of the Courts of Appeals." *Mobil Oil, supra,* —— U.S. at ——, 42 U.S. L. WEEK at 4850, *quoting from Universal Camera Corp.* v. *NLRB,* 340 U.S. 474, 491 (1951).

We cannot find on the basis of the evidentiary record developed by the Commission that it "has given reasoned consideration" and "appropriate protection" to the public interest in not paying prices for gas substantially in excess of those needed to induce production of an adequate gas supply.[30] Though the "substantial evidence" standard has been applied with some flexibility, under any interpretation of its stringency it can be stated that there is not sufficient evidence supporting the Commission's conclusion that Mitchell will not earn an excessive profit charging 30.25¢ per Mcf on both its old flowing and newly discovered gas in the Wise County region.

This deficiency in the Commission's order is critical. Protection of the consumer from profiteering in the gas industry was the primary purpose behind passage of the Natural Gas Act. "It is abundantly clear from the his-

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[29] The substantial evidence standard for appellate review of Commission orders derives from § 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b) (1970).

[30] *Mobil Oil Corp.* v. *FPC, supra* note 3, —— U.S. at ——, 42 U.S. L. WEEK at 4853.

tory of the Act and from the events that prompted its adoption that Congress considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas." *FPC* v. *Texaco, Inc.*, —— U.S. ——, ——, 42 U.S. L. WEEK 4867, 4872-4873 (June 10, 1974). The "only justification for giving the Commission the duty to regulate prices was the determination by Congress that the producers have a supply that is so restricted in relation to demand that they have the economic power to bargain for prices that will be injurious to the public." *United Gas Improvement Co.* v. *FPC*, 5 Cir., 290 F.2d 133, 135, *cert. denied*, 368 U.S. 823 (1961).[31]

The Commission determined early in its regulation of natural gas producers that protection of the consumer from these producers' market power could best be accomplished by setting rates tied to the producers' costs. In this way the producers' return on capital could be computed and held to that rate necessary to call forth needed gas supplies. As traced above, the Commission first set rates on an individual company cost basis before switching to its area-wide average cost policy. The Commission's cost-based approach to regulation obtained unanimous judicial approval. As stated by Judge MacKinnon, "[W]hen the inquiry is whether a given rate is just and reasonable to the consumer, the underlying

[31] As the original § 7(c) provided, it was "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest." 52 Stat. 825. The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges.

Atlantic Refining Co. v. *Public Service Com'n (CATCO)*, 360 U.S. 378, 388 (1959).

consideration is whether it is *low* enough so that exploitation by the producer is prevented. * * * [N]o factors apart from producers' costs are available to guide efforts to make that determination from the standpoint of the consumer." *City of Chicago* v. *FPC*, 147 U.S.App.D.C. 312, 332, 458 F.2d 731, 751, *cert. denied*, 405 U.S. 1074 (1971) (emphasis in original).

The courts have also made it clear that the Commission cannot fulfill its "responsibility to maintain adequate supplies at the lowest reasonable rate," *Mobil Oil Corp.* v. *FPC*, *supra*, —— U.S. at ——, 42 U.S. L. WEEK at 4853, by assuming without consideration of producers' costs that the market price of gas in unregulated markets is a "just and reasonable" one. As recently as this term the Supreme Court spelled out to the Commission that in "subjecting producers to regulation because of anti-competitive conditions in the industry. Congress could not have assumed that 'just and reasonable' rates could conclusively be determined by reference to market price." *FPC* v. *Texaco, Inc.*, *supra*, —— U.S. at ——, 42 U.S. L. WEEK at 4873.[32] In this case the Commission could not base a determination that Mitchell's 30.25¢ per Mcf rate for new and old gas was just and reasonable solely on a comparison of this rate with alternative gas prices such as those in the unregulated intrastate gas market. Such a "what the market will bear" approach is simply inconsistent with the Commission's regulatory trust.

We perceive no reason why the special relief provisions in the Commission's area rate orders cannot be

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[32] *See also City of Chicago* v. *FPC*, 147 U.S.App.D.C. 312, 349-350, 458 F.2d 731, 768-769, *cert. denied*, 405 U.S. 1074 (1971); *United Gas Improvement Co.* v. *FPC*, 5 Cir., 290 F.2d 133, 135-136, *cert. denied*, 368 U.S. 823 (1961).

utilized to encourage needed gas exploration.[33] But when the Commission permits an individual producer to depart from an area rate structure which has been developed with reference to average area-wide costs to provide producers a necessary but not excessive profit incentive for gas exploration, its regulatory trust requires it to give *complete consideration* to that producer's individual costs in order to ensure that the producer's profit margin is not thereby raised to an unreasonable level.

The Commission did not give such consideration to the profits Mitchell will obtain from Natural's consumers under a 30.25¢ per Mcf rate. The Commission's discussion of the estimate of the excess of 1973 through 1977 revenues from its rate increase over the costs of the new Wise County drilling surely did not constitute such consideration. As stressed by Chairman Nassikas in his dissent, the new wells drilled in the Wise County region are expected to produce gas for many years beyond 1977 and the revenues, as well as any costs, from the late years of production need to be taken into account on a discounted basis in order to calculate the incremental profit which Mitchell will obtain from the settlement agreement.[34] In addition, the Commission should have obtained past cost data from Mitchell in order to compute the profits which it had been obtaining at its old rate level on its old flowing gas. Because area rates are com-

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[33] Dicta in *Placid Oil Co.* v. *FPC*, *supra* note 12, 483 F.2d at 913, and *OSWA I*, *supra* note 16, 484 F.2d at 480 n.22, referring to the opinion challenged here as a possible application of the Commission's special relief procedure in this time of gas shortage constitute at most a 5th Circuit concurrence in this view.

[34] We note that the Commission's exclusive focus on the 1973 through 1977 period for computation of Mitchell's incremental profits was inconsistent with its consideration of the productive life of the new wells for purposes of computing the incremental price of the new gas. *See* note 23 *supra*.

puted with reference to average costs, it is very possible that these profits were much greater than the average considered reasonable by the Commission for the Other Southwest Area.[35] Mitchell's incremental profits need to be supplemented with this old profit margin to compute its new profit expectations. Only incremental profits would, of course, be directly relevant to Mitchell's decision whether to invest in additional drilling, but the Commission must consider Mitchell's overall profits to determine the general reasonableness of the rate increase. If Mitchell's profit returns on old flowing gas at its old rate were already above the area average, the Commission might decide that the rate on the newly drilled gas, but not that on the old flowing gas, should be increased so that Mitchell, rather than Natural's ratepaying customers, would bear what seemed the minimal risk of the new drilling being unsuccessful.[36]

A higher overall profit return derived from lower than average costs on the old flowing gas should also be relevant to the Commission's consideration of whether Mitchell's *quid pro quo* for its rate increase—its exploration commitment—is adequate. Higher profit levels would demand a greater gas exploration commitment, and greater support for Chairman Nassikas' position that all gas found by such a commitment be dedicated to the interstate market.[37]

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[35] The Commission seems to have settled upon a 15% rate of return for producers as reasonable. *See Other Southwest Area Proceeding, supra* note 9, 46 FPC at 913 n.15.

[36] *See* note 26 *supra.*

[37] Though we do not and need not rest our disposition on this point, like Chairman Nassikas we are troubled by the Commission's failure to require Mitchell to invest in exploration for gas to be dedicated to the interstate market all of its Wise County region revenues in excess of those it would have obtained at the area rate. The excess revenues, at least over the productive life of the wells and perhaps over five years,

III

We remand this case to the Commission for reconsideration of the reasonableness of Mitchell's settlement agreement in light of a full evidentiary record on Mitchell's costs of production in the Wise County contract region and the profits which it can expect to obtain over the life of its new and old wells in this region. Inasmuch as Mitchell is now in its second year of drilling toward its 125-well Wise County region commitment and the success ratio of this drilling can be determined, the Commission can make accurate estimates of the amount of gas Mitchell will be able to sell as a result of its exploratory investments.[38]

It is for the Commission to determine that rate level which is necessary to induce Mitchell to complete its drilling in the Wise County region, and it is for the Commission to determine whether the overall profits which Mitchell would obtain at that level are reasonable in light of any commitments to provide further gas for the

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see note 25 *supra*, will be greater than Mitchell's $16.5 million exploration commitment. Moreover, $7.5 million of the $16.5 million may be directed toward exploration for gas or oil which may never reach the interstate market. A requirement that all the excess revenues be employed to ease the interstate gas shortage would have given symmetry to the purpose of the grant of relief and Mitchell's *quid pro quo* to obtain the relief. The symmetry would have been perfected had the Commission given preemptive rights on the gas obtained from the exploration to Natural whose ratepaying consumers effectively funded the new drilling.

[38] The dispute between petitioners and the Commission as to the quantities of gas which Mitchell will be able to sell at the increased rate, *see* note 25 *supra*, should be able to be resolved. The Commission also should fully explain why it reduced its original $7.7 million incremental five-year profit calculation to $3 million. *See id.* It should specify the apportioned corporate overhead and severance and *ad valorem* tax costs.

interstate market.[39] If made within a "zone of reasonableness," [40] we are to respect those determinations [41] as a balancing of public interests within the Commission's discretion.[42] However, these determinations cannot be made without full consideration of Mitchell's costs. Absent such a full consideration, we cannot conclude that the Commission's order granting Mitchell special relief from the area rates is "supported by substantial evidence." [43]

Remanded for further proceedings consistent with this opinion.

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[39] If the Commission decides upon reconsideration that only a rate lower than 30.25¢ per Mcf is justified, it should consider the equities of ordering a refund to Natural of excess revenues already collected to be passed through to the ultimate ratepaying consumers.

[40] *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

[41] A Commission decision that extra profits are justified by a commitment to explore for more gas would be more clearly within a "zone of reasonableness" if *all* the extra profits were required to be invested in exploration which would benefit the ratepaying consumers who provided the extra profits or at least other consumers who purchase from the interstate market. *See* note 37 *supra*. If such a requirement is not placed on a producer obtaining special relief in a case such as Mitchell's, the Commission should at least fully explain why. The Commission should also consider the exploratory investments which the producer has made over the past few years, *see* note 22 *supra*, to determine whether its commitment to do further exploration is really a *quid pro quo*. The Commission should at least attempt to make the exploratory commitment an incremental one.

[42] *See* the language quoted from *Permian Basin*, *supra* note 40, in text at note 29 *supra*.

[43] 15 U.S.C. § 717r(b).

MACKINNON, *Circuit Judge*, concurring: I concur in the foregoing opinion except as to part of footnote 2. It is my opinion that since Congressman Macdonald is clearly not aggrieved by the order, this court lacks jurisdiction over his petition under section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b). It is unnecessary to consider the further question whether his petition would satisfy the case or controversy requirement of Article III of the Constitution.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

George Mitchell & Associates) Docket No. RI73-60

OPINION NO. 649

OPINION AND ORDER GRANTING SPECIAL RELIEF AND TERMINATING PROCEEDINGS

Issued: February 21, 1973

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

George Mitchell & Associates) Docket No. RI73-60

OPINION NO. 649

APPEARANCES

Homer J. Penn for George Mitchell & Associates

James Hamersley, Joseph Wells, and *Paul Goldstein* for Natural Gas Pipeline Company of America, Peoples Gas Light and Coke, and North Shore Gas Company

J. Stanley Stroud, Justin A. Stanley, and *Wendell H. Adams, Jr.,* for Northern Illinois Gas Company

Richard G. Morgan, John E. Holtzinger, Jr., and *Frederick Moring,* for Associated Gas Distributors

William J. Ryan, Frank Kelly, and *Robert Perdue* for the Staff of the Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John N. Nassikas, Chairman; Albert B. Brooke, Jr., and Rush Moody, Jr.

George Mitchell & Associates) Docket No. RI73-60

OPINION NO. 649

OPINION AND ORDER GRANTING SPECIAL RELIEF AND TERMINATING PROCEEDINGS

(Issued February 21, 1973)

MOODY, Commissioner:

On August 11, 1972, George Mitchell & Associates, Inc., Agent, and Mitchell Energy & Development Corp. (Mitchell) filed a petition for special relief pursuant to Section 154.109(f) of the Commission's Regulations under the Natural Gas Act, requesting authorization to collect a rate of 30.25¢ per Mcf[1] for sales of its interest in natural gas delivered to Natural Gas Pipeline Company of America (Natural) from the Boonesville Bend Field, Jack, Wise and Parker Counties, Texas (Texas Railroad Commission District Nos. 7-b and 9)[2]. The increased rate is contractually authorized pursuant to the terms of Mitchell's contract with Natural, dated July 12, 1954, as amended July 5, 1972.

Mitchell's petition is within the purview of Section 154.109(f) of our Regulations, and was filed after a unanimous Commission stated[3], on April 6, 1972:

> Mindful of the national gas supply problem . . . , the Commission reaffirms its obligation to consider applications for special relief under Sections 4 and 7

[1] Mitchell is presently charging and collecting rates of 18.20¢, 19.70¢, 22.5¢, and 24¢ per Mcf for such gas. The weighted average rate is 18.859¢ per Mcf.

[2] Referred to hereinafter as "The Wise County Area".

[3] Notice of Rulemaking, Docket No. R-441.

of the Natural Gas Act for contractually authorized rate increases for gas sold under certificates of public convenience and necessity heretofore issued. Neither the moratoriums imposed in area rate decisions, nor our regulations preclude the right of an individual seller to apply for special relief and demonstrate that a contractually authorized increase is necessary, even if such increase involves rates above area ceilings. In considering individual applications for special relief, we are required by the Natural Gas Act to determine if a departure from area ceiling rates is required by the public interest. Upon an applicant's showing that the proposed contractually authorized amendment will result in securing a substantial net increase in the supply of gas for the interstate market, a determination of public convenience and necessity will be undertaken by the Commission in the light of the standards set forth in *Austral Oil Co.* v. *F.P.C.*, 428 F.2d 407 (5th Circuit 1970), cert. denied 400 U.S. 950 (1970).

In assessing Mitchell's petition, we are mindful of our previous recognition of the importance of the relationship between cash flow generated by sales of flowing gas and an expanded exploration and production effort. For example, in Opinion 598, AR61-2, *Southern Louisiana Area Rate Proceeding*, 46 FPC 86 (July 16, 1971), we said:

> Revenues from flowing gas (gas delivered under contracts dated prior to October 1, 1968) are an important source of funds for new investments by the producers. We recognized in Opinion No. 546 that "revenues from sales of gas under contracts dated prior to 1961 continue to constitute a large portion of the total revenues derived by producers from gas sales in Southern Louisiana." The funds to support exploration for and development of new gas supplies come from all gas sales . . . .
>
> . . . the significant argument is whether flowing gas realizations should bear a part of the responsibility for assuring a cash flow to meet the needs for a height-

ened exploration and production effort. We believe they should....

We reaffirm this reasoning.

We have received but few petitions for special relief since the procedure was first recognized in Opinion 468, *Permian Basin Area Rate Proceedings,* 34 FPC 159 (August 5, 1965) aff'd, *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968). Mitchell's petition affords the first opportunity for us to express our views on the use of special relief procedures as a means of alleviating the national gas shortage through expanded domestic exploration and development, and in assessing the record here, we have sought to determine the justness and reasonableness of the proposed rates by testing them in the light of cost and non-cost factors as directed by *Austral.* We are particularly concerned with the supply-price-demand relationship, capital formation within the producing industry, the consequences of our order upon the producing industry, and whether the order provides appropriate protection to the relevant present and future public interests. This Commission may employ any formula or combination of formulas it wishes and is free to make pragmatic adjustments which may be called for by particular circumstances. *F.P.C.* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 586. *F.P.C.* v. *Louisiana Power & Light Co.,* 406 U.S. 621 (1972).

On October 3, 1972, the Commission issued an order providing for hearing on Mitchell's petition for special relief, and set October 20, 1972, as the date for filing of Mitchell's testimony, and November 8, 1972, as the date for an initial prehearing conference to be convened for purpose of settlement. Petitions to intervene filed by the following parties were granted.

Associated Gas Distributors
Natural Gas Pipeline Company of America
Northern Illinois Gas Company

North Shore Gas Company
The Peoples Gas, Light and Coke Company

At the hearing herein Mitchell presented testimony and evidence of five witnesses, Natural presented the testimony of one witness, and one witness introduced testimony and evidence for the staff.

As a consequence of conferences held by all the parties, pursuant to Section 1.18 of the Rules of Practice and Procedure, there is now before us for consideration a Motion for Promulgation of Settlement Proposal filed in this proceeding by Mitchell on December 15, 1972.

The settlement proposal involves (a) Mitchell's July 5, 1972, contract amendment with Natural which is the subject of Mitchell's original petition for special relief and which provides for an initial price of 30¢ per Mcf, with 1¢ per Mcf escalations every five years for the life of the lease; and (b) a proposal by Mitchell that during the five-year period commencing January 1, 1973, it will spend for drilling activities the sum of $16,496,847 within the continental United States, and the additional sum of $2,000,000 for compression facilities in the Boonesville Bend Field area.

Specifically, the settlement proposal provides:

(1) Mitchell will undertake a program of drilling at least 125 additional wells in the Wise County Area, as such area is defined in the July 5, 1973, contract amendment between Mitchell and Natural. All natural gas obtained from such additional drilling is to be sold to Natural in interstate commerce pursuant to the terms and conditions of the July 5, 1972, contract amendment.

(2) Upon Commission waiver of the applicable area ceiling rates and the Commission's grant of special relief under Section 154.109(f) of the Commission's Regulations under the Natural Gas Act, Mitchell shall collect from Natural 30¢ per Mcf

plus .25¢ per Mcf plant dehydration allowance without upward Btu adjustment, for only its interest in the gas[6].

(3) Mitchell shall install additional field compression when needed on the gas gathering facilities owned by Natural upstream from the inlet of Mitchell's Bridgeport Plant.

(4) Mitchell and its affiliated companies, GM&A Gas Products Plant, Inc. and Mitchell Energy Offshore Corporation, during the five year period commencing January 1, 1973, shall spend for drilling activities the sum of $16,496,847 exclusive of contributions from any other interest owners, within the continental United States.

(5) Mitchell shall grant to Natural a preferential right to purchase at the then existing competitive rates for new gas supplies all gas outside the contract area which may be developed by Mitchell in the State of Texas that lie within 25 miles of Natural's or its affiliated gathering and transmission facilities at the date of this settlement. Further, if Natural fails to take such gas, Mitchell shall make a good faith effort to offer the gas developed as a result of the expenditures provided for in the proposal to the interstate market to the extent that such interstate market is price competitive with the intrastate or local market.

(6) Mitchell shall report to the Commission within 90 days of each fiscal year which ends January 31 of each year its total expenditure for drilling and exploration (exclusive of any general and administrative overhead). Mitchell shall separately report the number of wells drilled within the (Wise County) area and the dollar expenditures with respect thereto on the same basis. Copies of such report shall be furnished to all of the intervenors herein.

[6] Mitchell has a 59% working interest in the gas now being sold and delivered to Natural. Its interest percentage in the incremental volumes of gas to be sold will vary from lease to lease. The proposed increase runs in favor of Mitchell only, and the rates of non-signatory parties are not increased.

The instant settlement proposal is not opposed by any party to this proceeding. Commission staff participated in the conferences culminating in the settlement agreement, and has entered no objection to it.

Notwithstanding the unanimity of the parties before us, including our staff, on the advantages of the settlement proposal, it remains our duty to examine the record and determine if the public interest is served by the grant of the special relief sought. We act on the basis of a full record, so presented that our decision is one of judgment and discretion, not involving the resolution of contested facts.

As the impact of a natural gas shortage, which has now reached devastating proportions, is increasingly felt by the consuming public we are charged to protect, *we must decide our cases in the context of our duty to seek a reliable and adequate supply of gas at the lowest reasonable cost.* Those consumers who are being curtailed, those who face curtailment, those who pay a higher unit cost because the servicing pipeline is operating at lower capacity, those who pay more because of the addition of LNG or SNG to the system, and those who have been denied service because of the shortage are entitled to demand of us a careful and thoughtful consideration of gas supply. "Lowest reasonable cost" has no meaning in regulation unless its determination encompasses consideration of reliability and adequacy of supply. If we are so concerned with price as a measure of profit that we ignore the effect of price on supply, we fail in our essential function.

Policies which disregard the importance of adequate pricing to cash flow in the formation of exploration and development capital act as a disincentive to the search for new natural gas supplies.

The American social and economic system has been nourished by the availability of abundant and inexpensive energy. Natural gas, in particular, over the past 25 years has

expanded to occupy a significant proportion of the energy market — an ascendancy promoted and sustained by price regulation policies.

The Nation is presently beset with supply problems across the entire energy spectrum, and both short-term and long-term adjustments and accommodations are necessary. As far as natural gas is concerned, the one inescapable conclusion is that the United States will never again enjoy the luxury of hitherto unlimited supplies at the low prices of the past.

Higher prices for a product that has been historically inexpensive are immediately translated by some into excess profits — a preoccupation that ignores current economic facts of life and automatically writes off "profits" or "earnings" as a basic ingredient of risk investment decisions.

Establishing area rates for producer sales is subject to somewhat the same infirmity of imprecision as determining a pipeline rate of return. Final rates in both instances emerge from human judgement of the evidence at hand.

Recognizing that there may be circumstances warranting exceptions to the general rules, we established a special relief procedure in the *Other Southwest Area* under which a producer would be given opportunity to demonstrate to this Commission why the nature of his situation calls for different treatment. This is precisely what Mitchell has done.

In this case, we have measured the settlement's price adjustments against Mitchell's commitment to increase gas supplies and deliverability and found both to be in the public interest. We are convinced that Natural and, indeed, the interstate market are placed in position of obtaining volumes of gas they would have otherwise been denied at a price entirely just and reasonable.

1. *A developing shortage.* On July 12, 1954, Natural contracted to purchase gas produced by Mitchell from leases covering 1,268,236 acres in Jack, Wise and Parker Counties, Texas. The initial price was 13¢/Mcf, but the contract called for price redeterminations at five-year intervals. The contract term was for twenty years from the date of first delivery. Mitchell commenced development of the dedicated acreage. Twenty wells were drilled and completed in 1954, resulting in 63,000 acres of total proved acreage. The pace of development quickened. By the end of 1964 a total of 404 gas wells had been completed, and total proved acreage rose to 135,000 acres.

In 1965, however, development efforts were curtailed. While a total of 65 wells were drilled and completed in 1964, 1965 saw only 49 new wells; in 1966 only 31 wells were drilled and completed, and during 1971 only 14 new wells were brought on stream. At the end of 1972, a total of 193,000 acres had been proved as gas productive.

The effect of the declining rate of development is soon to be felt by the consumers served through Natural's purchase of Mitchell gas. Annual deliveries for 1972 from Mitchell to Natural, prior to processing, were approximately 47,973,000 Mcf. If no new effort at development is made, deliveries will decline in 1973 and will continue to decline at increasing rates over the coming years. An independent study by DeGolyer and McNaughton shows the decline to be as follows:

1972	47,973,000 Mcf
1973	40,746,000 Mcf
1974	35,006,000 Mcf
1975	30,236,000 Mcf
1976	26,413,000 Mcf
1977	23,204,000 Mcf

Natural has performed its own studies of anticipated deliverability from the Wise County area. These studies

cover all Wise County area sources, of which Mitchell's Boonesville Bend Field production is the largest component, and they show:

1973	49,900,000 Mcf
1974	48,700,000 Mcf
1975	42,500,000 Mcf
1976	36,700,000 Mcf
1977	32,800,000 Mcf

Of equal significance, if no new development effort occurs, there will be forever lost by abandonment in place a total of 25 Bcf of natural gas. This volume is not economically recoverable, according to the uncontested record before us, at the present rate level.

2. *The effect of reduced deliverability.* Natural depends upon Mitchell gas as a significant source of system supply. Natural has invested $14,000,000 in facilities to take this supply. Natural is, and has been from time to time since 1970, in curtailment. Natural's supply problem is particularly acute along its "Amarillo Line" which receives a significant part of its supply from sales made by Mitchell. Some consumers dependent upon Natural are faced with a less than adequate supply of gas. Even those customers who receive an adequate supply face increased charges solely because of curtailment because unit cost to them is determined by dividing costs by the number of units of gas delivered. For Natural, applying the information available from its most recent rate filing, RP72-132, the pattern of increased unit cost is as follows:

	0% Curtailment	5% Curtailment	10% Curtailment	15% Curtailment	20% Curtailment
Cost of service	$ 502,035,949	$ 489,394,241	$ 476,752,533	$464,110,825	$451,469,117
Applicable volumes	1,176,396,986	1,117,577,137	1,058,757,287	999,937,438	941,117,589
Unit Cost	42.68¢	43.79¢	45.03¢	46.41¢	47.97¢

Natural has attempted to meet the needs of its customers. During 1971-72, it made emergency and limited-term purchases of 22,287,000 Mcf at an average cost of 33.6¢/Mcf. It has continued its aggressive efforts to contract for long-term supplies, and it has been active in an advance payments program, advancing $120 million for domestic supplies under Orders 410, 410-A and 441. Natural has sought out non-conventional sources such as LNG and SNG, but these efforts are some years away from fruition, and when implemented will involve a cost of gas in excess of $1.00/Mcf. Despite these efforts, Natural has, since June 1970, been forced to curtail deliveries to the extent of 253,000,000 Mcf, and further large and increasing curtailments are projected.

3. *Reasons for non-development.* As already noted, the unquestioned studies in this record reflect that there are substantial quantities of gas in place underlying the Mitchell acreage, which reserves are characterized by an independent geologist as "proved". While many thousands of acres dedicated to the Natural contract remain unexplored, there are at least 60 well locations now owned by Mitchell which are classed as good prospects for gas production. In addition there is unleased acreage in the Wise-Parker-Jack county area which Mitchell believes it can acquire for dedication to Natural. And this record clearly shows that based on actual well performance, each successful well drilled in this area adds to the total recoverable reserves. For example, in 1964, 53 new wells were completed for an average ultimate recoverable gas reserve of 987,000 Mcf per well; in 1971, 12 new gas wells were completed for an average ultimate recoverable gas reserve of 1,138,000 Mcf per well.

Why, then, does Mitchell not undertake the drilling of more wells to find more gas to sell to Natural for the interstate market? This record establishes an unequivocal answer, which is, quite simply, that nondevelopment of a

known gas reserve occurs here because of economics. Mitchell would be required to spend $8,975,000 to drill the 125 wells necessary,[4] and expend $2,000,000 for the compression necessary, to maintain Boonesville at its present level of deliverability. Mitchell would thus expend $10,975,000 in five years in order to sell an additional 37.1 Bcf of gas, but for that additional gas Mitchell would receive only $6,997,060. (37.1 Bcf x 18.86/Mcf, Mitchell's current rate level.) So long as this situation prevails, we must expect that the Boonesville Field will not be developed to its full potential, and that full exploration of the 1,268,236 acres dedicated by Mitchell to the interstate market will not occur. Even more tragic, maintenance of the Mitchell sale at the current area rate level will result in the failure to produce roughly 25 Bcf of gas — enough gas to heat 20,000 homes for 10 years. This economic waste occurs, according to an independent petroleum engineer, because production at the present rate level becomes uneconomic at a point in time when a portion of the remaining developed producing reserves are still unproduced. This unproduced increment of gas can be economically produced if the rate level were higher, to the extent of an additional 7½% of the total reserves if the applicable rate were 30¢/Mcf.

4. *Effect of denial of rate relief.* This record leaves no doubt as to the result of denying the request for rate relief. Mitchell's witnesses stated:

> The company was unwilling to drill any additional wells or to incur large sums of expense in maintaining deliverability under the present terms of the gas contract.... The principal reason for this was that... the company... could not drill a number of wells which had potential for gas but would not be economical at 17¢ per Mcf. (T.R. 25.)

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[4] Mitchell indicated in its testimony that in excess of 125 wells will be drilled if a success ratio of 60 percent can be met or exceeded.

> We certainly will not drill 125 wells in the Boonesville Bend Field nor will we add additional stage of compression (if the price increase is not granted). (T. R. 42).

5. *The application for special relief.* Against a background of Natural's urgent need for additional gas supplies, and Mitchell's inability to undertake further exploration and development at current rate levels, a bargain was struck which purports to balance the conflicting economic considerations here present. There is no suggestion in this record that the proposed rate relief was produced by less than arms-length bargaining. After the producer and pipeline reached agreement, the present application was filed. Interested parties intervened. A hearing was held with all witnesses subject to cross-examination. Ultimately one significant modification of the Mitchell-Natural proposal emerged from the hearing process, following which our staff endorsed the modified proposal. We examine the proposal for public interest benefits and detriments and find:

1. The consuming public served by Natural will be benefited by
   a. Maintenance of field deliverability at current levels.
   b. An additional 37.1 Bcf of gas over the next five years.[5]
   c. Ultimate recovery of additional gas over the life of the leases; the most conservative estimate is an additional 127.2 Bcf, but one witness says 250 Bcf will be produced.

[5] This is the expected additional volume to be sold by Mitchell; increased volumes of gas should also come from the non-Mitchell owned interests in the Boonesville Bend Field. If the current ratio of Mitchell owned working interest (59%) to non-Mitchell owned working interest (41%) is maintained, the total additional volumes for sale to Natural will be 62.9 Bcf.

d. Exploration of a gas-prone domestic area not heretofore fully explored.

e. Extension of gas purchase rights for the full life of leases covering over 1,200,000 acres.

f. Dedication of additional acreage to Natural by Mitchell.

g. Avoidance of increased costs occasioned by curtailment, premature abandonment of Natural's $14,000,000 facilities investment, and/or substitution of higher cost supply sources.

h. A drilling commitment of $7,500,000 for exploration and development in the continental United States, with the interstate market affored preferential rights to purchase gas production resulting therefrom.

2. The consuming public served by Natural undergoes the detriment of

a. An increase in Natural's rates of $0.0031/Mcf which will be occasioned by Natural's payment of increased prices for gas sold under the Mitchell contract, gas which is already flowing in interstate commerce.

b. Depending upon the success or failure of the 125-well program, Mitchell may receive more profit than it would earn if rate relief were not granted.

In our attempts to balance the factors here set forth, our guiding purpose is fulfillment of our duty to provide a complete and effective bond of protection for consumers of natural gas, by striving to call forth a reliable and adequate supply of gas at the lowest reasonable cost. *F.P.C.* v. *Hope Natural Gas Co.,* 320 U.S. 591 (1944). If we look only at

the fact of increased rates, and the possibility of a higher profit level for the producer, we will reject this, and every similar application that may be made. If, on the other hand, we look to the whole of our responsibility, approval of rate relief here is required. Of what benefit to Natural's consumers are we if we keep the rate level where it is, with full knowledge that the result will be either a shortened supply or fulfillment of needs through higher cost supplies? It may be politically expedient to call for no rate increases, but it is not responsible regulation to do so when the result is impaired consumer service.

We should not, of course, be understood to say that the level of producer profits is to be ignored. We have examined the proposal before us carefully, and note our staff's concern that the requested rate increase has the potential for generating approximately $3,000,000 in "excess" revenues to the producer. Such will result if the 125-well program is as successful as estimated and if Mitchell acquires 100% of the working interest in the new leases from which the gas is produced. We also note, however, that if the program is unsuccessful Mitchell will have expended $18,496,847 over the next five years in return for $7,733,810[6] in increased rates. The risk of almost $11,000,000 in capital funds, in the hopes of earning a total of $3,000,000 in "excess" revenues over a five-year period, does not reflect a windfall profit.

Any question of a potentially excessive profit pattern is resolved, however, by the provisions of the settlement proposal which require Mitchell to re-invest the sum of $3,000,000 plus an additional $4,521,947 of its own funds in exploration and development effort in the continental United States over the next five years. These expenditures are required, over and above the Mitchell commitment to

[6] The rate increase sought is from a weighted average of 18.86¢/Mcf to 30.25¢/Mcf, a difference of 11.39¢/Mcf. If no new gas is found, Mitchell will sell 67.9 Bcf at the increased rate of 11.39¢/Mcf.

spend approximately $8,975,000 in drilling 125 wells on the acreage dedicated, and to be dedicated, to the Natural contract. All gas found through the $7,521,947 commitment is committed by the settlement agreement to a preferential right of purchase by interstate pipelines. We find these provisions to be fully protective of the public interest.

The realities of today's gas shortage compel the Federal Power Commission to re-evaluate past attitudes and practices. Reiteration of the regulatory philosophy that "lowest reasonable cost" must be defined solely in terms of the producer's profit level would indeed make little sense to the consumers on Natural's system who judge the cost of gas to them in terms of what they pay, month by month. We have a clear choice in this case. We can, and we must, look at "lowest reasonable cost" in terms of actual consumer rate impact. Consumer protection becomes a meaningless term if we shut our eyes to the undisputed facts here presented that the grant of a rate increase to Mitchell results in a lower cost to the consumer than a denial of the rate increase. Natural can seek to fill the gap left by reduced deliveries from Mitchell by (a) purchasing emergency supplies, or (b) adding SNG, LNG or other supplemental sources. Either of these actions will raise the delivered price of gas to the ultimate consumer more than the increase which grant of Mitchell's application entails.

We see no benefit to the consuming public, nor any degree of protection for them, if we "save" them from so-called windfall profits at the expense of adequate supplies, or if we "protect" them against so-called exorbitant rates at the expense of even higher gas bills which result from the sale to them of higher-priced supplemental gas. Whatever the inadequacies of the Natural Gas Act, it does not authorize so absurd a result.

Our action in granting the special relief sought herein is taken only upon the peculiar facts and circumstances pre-

sented. Such action may or may not be applicable to other circumstances, and it in no way affects the general applicability of the just and reasonable rate determinations made by us in our Opinion Nos. 607 and 607-A.

In the settlement proposal it is urged that the Commission waive the 30-day statutory notice period under Section 4(d) of the Natural Gas Act for Mitchell's notice of change in rate filing. As a basis for this request, the proposal notes the obligation imposed upon Mitchell by the terms of the settlement proposal which are tied to the calendar years 1973 through 1977. It is appropriate in this instance to waive such notice requirement for good cause shown.

The Commission finds:

1. The proposed settlement of the subject proceedings, on the basis described herein, as more fully set forth in the settlement proposal and the appendices thereto, filed by Mitchell on December 15, 1972, is in the public interest, and it is appropriate in carrying out the provisions of the Natural Gas Act that it be approved and made effective as hereinafter ordered.

2. The rate increase granted in this case has been reviewed in the light of and is consistent with the Economic Stabilization Act of 1970 as amended, Executive Order 11695, and the Rules and Regulations issued thereunder.

The Commission orders:

(A) The settlement of these proceedings on the basis of the settlement proposal filed by Mitchell on December 15, 1972, is approved and made effective subject to the terms and conditions herein, and the petition for waiver filed in accordance with Section 154.109(f) of the Commission's Regulations is granted.

(B) The rate filing of 30¢ per Mcf plus .25¢ per Mcf plant dehydration allowance, without upward Btu adjust-

ment, by Mitchell will become effective as of the date of issuance of this order and the 30-day statutory notice period is hereby waived.

(C) The settlement proposal, contract amendment and notice of change in rate schedule designated as follows are accepted for filing as supplements to Mitchell's FPC Gas Rate Schedule No. 19 effective on the date of issuance of this order:

Description	Supplement No.
Settlement Proposal filed December 15, 1972, and Contract Amendment dated July 5, 1972	40
Notice of Change in Rate December 14, 1972	41

(D) Upon effectuation of the terms and conditions of this order, the proceedings in Docket No. RI73-60 are terminated without further order of the Commission, *provided,* however, that Mitchell shall file such annual reports as proposed in the settlement agreement approved herein.

By the Commission. Chairman Nassikas dissenting, filed a separate statement appended hereto.

(SEAL)

Kenneth F. Plumb,
Secretary

(Issued February 21, 1973)

Nassikas, Chairman, *dissenting:*

Having without avail urged the remand of this proceeding for further hearing before an administrative law judge, I am compelled to dissent on two basic grounds: first, the settlement is not based on an evidentiary record, and second, the settlement is violative of the public interest.

While the private interest of the petitioner is well served, the consumer and public interest are not. Acceptance of

the majority's extraordinarily contrived doctrine that producer costs and profits are irrelevant to our obligation to "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges"[1] is an open invitation to all producers to apply for increases in rates above the lowest reasonable cost to obtain adequate supplies for reliable service to the consumer.

Since August 1, 1969, I have assigned top priority to establish and implement Commission policies to mitigate the effects of a deepening gas crisis which was evident at that time. But "crisis" cannot be used as the basis for approving proposals not substantiated by evidence which use the device of higher consumer prices to create a riskless fund of capital for a producer to generate profits in an undisclosed amount for partial dedications of incremental gas to the interstate market.

Mitchell's petition is for special relief from area ceilings and must be so judged.[2] In *Permian,* the Commission indicated that a producer could seek relief where its out-of-pocket expenses exceeded the revenues under the applicable area price.[3] The burden is, of course, upon the producer to establish support for such an exception. I search this record and the record in *Other Southwest* in vain to find any cost evidence by Mitchell to show why its operations differ from those of other producers in the *Other Southwest Area* so as to warrant special relief.

There are no costs, other than those of drilling 125 wells and the compression facilities, in this record to determine if

[1] *Atlantic Refining Co.* v. *P.S.C. of New York,* 360 U.S. 378, 388 (1959); *F.P.C.* v. *Hope Natural Gas Co.,* 320 U.S. 591, 612 (1944); *City of Detroit* v. *F.P.C.,* 230 F.2d 810, 817 (CADC, 1955).

[2] *Permian Basin Area Rate Cases,* 390 U.S. 747, 770-2 (1968). Compare *F.P.C.* v. *Texaco, Inc.,* 377 U.S. 33, 40 (1964); *Total Telecable, Inc.* v. *F.C.C.,* 411 F.2d 639, 642 (9th Cir., 1969); *Pan American Petroleum Corp.* v. *F.P.C.,* 352 F.2d 241, 245 (10th Cir., 1965).

[3] 34 FPC at 226; 390 U.S. at 770-2.

Mitchell's petition for special relief from area ceilings is supported by substantial evidence. There are no such costs in the *Other Southwest Area Rate Proceeding*, inasmuch as Mitchell did not file any producer costs for his flowing gas.[4] The Mitchell witness in that case attempted to justify a purported cost of over 20 cents per Mcf in Texas R.R. District 9 and separate pricing relief for this area which was rejected by the administrative law judge and affirmed by a unanimous Commission.[5] The staff witness in that case testified, and the administrative law judge so found, that "little or no cost data were reported for the Boonsville area, where the reserves are old, shallow, and presumably less costly."[6] In other words, one cannot compare the costs, if any, supporting this petition, as being higher than those reviewed in the *Other Southwest Area*, because there is no basis for comparison in the absence of cost data for Texas R.R. District 9.

In the absence of record evidence, I cannot grant special relief. Instead, I would grant Mitchell the right to prove his case by remand. I cannot subscribe to the majority's doctrine that seller's costs are irrelevant to consumer protection.

I.

The majority relies upon the fact that the settlement was supported by all parties and staff as a basis for affirming the settlement as presented. Parties cannot stipulate the public interest which Congress has entrusted to the Commission and its staff.[7] Here staff passively endorsed the settlement without any cross-examination or sponsoring any independent evidence or testimony, except Exhibit 12, which

[4] 46 FPC 983, 1048 (1969).

[5] 46 FPC 900, 923 (1971).

[6] 46 FPC at 1048.

[7] *Pennsylvania Gas and Water Co.* v. *F.P.C.*, 463 F.2d 1242 (CADC, 1972). See the joint dissent of Commissioner Moody and myself to Opinion No. 619, May 19, 1972.

was then promptly ignored as a basis for the settlement. Acceptance of the settlement defies "... the right of the public [to] receive *active* and affirmative protection at the hands of the Commission [and its staff]."[8] Exhibit 12 presented uncontradicted evidence showing that approval of the settlement would result in George Mitchell receiving $7.7 million in revenues over the cost of drilling of the wells during the five-year period.[9] After a settlement conference, inexplicably $7,700,000 was reduced to $3 million.[10] Notwithstanding, in approving the settlement the majority accepts the $3 million without further inquiry. Acceptance of a $3 million forecast of revenues over cost is at best a conclusory finding without articulated reasons that such a finding represents a rational determination consistent with settled regulatory law.[11] Rates approved without substantial evidentiary support and thus with no standard for appellate review are unlawful.[12] Since there is no cost evidence in the record to determine the level of Mitchell's costs or return from his proposed drilling program, the majority's prescription of a 67% increase in flowing gas rates constitutes reversible error.

II.

Mitchell's petition is for a rate of 30¢ (plus .25¢ for dehydration allowance) per Mcf for both flowing and new gas.

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[8] *Scenic Hudson Preservation Conference* v. *F.P.C.*, 354 F.2d 608, 620 (CA2, 1965), cert. denied 384 U.S. 941 (1966) (emphasis supplied). *Cf. Udall* v. *F.P.C.*, 387 U.S. 428, 450 (1965); *Environmental Defense Fund, Inc.* v. *Hardin*, 439 F.2d 584, 595-8 (CADC, 1971). See *Greene County Planning Board* v. *F.P.C.*, 455 F.2d 412 (CA2, 1972), cert. denied, ... U.S. ... (October 10, 1972).

[9] Exhibit 12, Sch. 2, Line 10.

[10] Tr. 137. Only part of the reduction can be attributable to *ad valorem*, severance taxes, and general corporate overhead. The justification for the reduction remains a mystery.

[11] *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); *Alabama Power Co.* v. *F.P.C.*, 450 F.2d 716, 721 (CADC, 1971).

[12] Section 19(b) of the Natural Gas Act. E.g., *Colorado-Wyoming Gas Co.* v. *F.P.C.*, 324 U.S. 626, 634 (1945).

The maximum area ceilings prescribed for Texas R.R. District No. 9 in Opinion No. 607[13] (issued October 29, 1971 by a unanimous Commission) were 18.7¢ per Mcf for flowing gas and 24¢ for new gas. The average contract rate presently being charged by Mitchell is 18.859¢ per Mcf, which was filed for on December 27, 1972.

The limited record below indicates that without additional drilling and compression Natural will receive about 68 Bcf over the 1972-1977 period and Mitchell will receive revenues of about $12.8 million from the Boonesville Field.[14] By approval of the settlement, Natural is estimated to receive 105 Bcf, or an additional 37 Bcf with added drilling and compression, and Mitchell will receive revenues of $31.5 million over the same 1972-1977 period, or a differential of $18.7 million for the incremental 37 Bcf. In other words, Natural's consumers are being asked to pay 50.39¢ per Mcf in the field for 37 Bcf of gas, ranging from 97¢ per Mcf in 1973 to 40¢ per Mcf in 1977.[15] The costs estimated to drill 125 wells and install additional third-stage compression are estimated to aggregate $11 million.[16] Thus, staff's Exhibit 12 estimated Mitchell would receive $7.7 million in revenues over cost during the first five years.[17]

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[13] 46 FPC 900.

[14] Exhibit 12. Tr. 35, 100.

[15] Exhibit 12, Sch. No. 2, Line 7.

[16] *Id.* at lines 8 and 9, indicating $9 million for drilling and $2 million for compression.

[17] There is the potential that an additional 37.1 Bcf could be developed under the drilling program. While Mitchell has a 59% working interest in presently flowing gas, there is nothing in the record to indicate what Mitchell's interest will be from production of the 125 wells. Even assuming that Mitchell's working interest will continue to be 59% (footnote 6, majority opinion), and Mitchell will sell an additional 21.8 Bcf (37.1 Bcf x 59%), then the incremental cost of these *lesser* volumes approximates 65¢ per Mcf (67.9 Bcf plus 21.8 Bcf x 30¢ per Mcf results in revenues of $26.9 million compared to $12.8 million revenues for 67.9 Bcf at present ceilings or incremental revenues of $14.1 million for 21.8 Bcf); not 50.39¢ per Mcf.

While LNG and SNG prices approximate a delivered cost of $1.00 per Mcf,[18] an incremental price of 50-65¢ at the wellhead, plus transportation costs of 25¢ to the city gate offers a more realistic comparison. More importantly, the present prices in the intrastate market are 35¢ per Mcf.[19]

III.

The majority indicates that Mitchell is investing $11 million in risk capital in hopes of earning $3 million in revenues over cost during the five-year period. Based upon Mitchell's past success ratio in the Boonesville Field,[20] the so-called "risk" commitment may be in part illusory. In any event, I do not view a $3 million return in five years on an $11 million investment occasioned by increased revenues primarily from flowing gas to be purchased by Natural's customers at 67% above present rates as anything but a "windfall profit" in the context of this settlement. Indeed, the logic of the settlement could dictate expenditures as high as $12.2 million,[21] rather than $7.5 million, so that Mitchell is reinvesting only a portion of the proceeds available from approval of the settlement, and is in fact receiving a "windfall" of the difference, i.e. $4.7 million.[22]

Mitchell will receive gross revenues of $20.4 million on 68 Bcf at the new rates, or $7.6 million more than revenues received without additional drilling,[23] if he conducts the

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[18] Tr. 35.

[19] Tr. 7-8, 27. November 14, 1972, Docket No. R-389A, showed weighted average intrastate contract rates of 34.41¢ per Mcf for the Other Southwest Area and 17¢ per Mcf in Texas R.R. District 9.

[20] Tr. 52.3 indicates 65% success ratio in last five years.

[21] Figures derived from $4.5 million in historical expenditures in 1967-1971 and $7.7 million revenues over cost in Wise County. Exhibit 12, line 10.

[22] If the 1972 levels of exploration would continue this potential windfall would be $7.2 million ($7 million plus $7.7 million less $7.5 million).

[23] Exhibit 12. Mitchell receives $12.8 million without drilling at present rates; at new rates and no additional gas volumes, he receives $20.4 million (30¢ per Mcf x 68 Bcf).

125 well drilling program and finds no gas, i.e. all 125 wells are dry holes. If all holes were dry, which is not probable, Mitchell would incur dry hole costs of about $7.5 million.[24] In other words, Mitchell will break even in Boonesville at the prices approved in the settlement even finding no gas and Natural's ratepayers will completely underwrite Mitchell's risk and will have received nothing from their capital contribution of $7.6 million.

IV.

The basic premise of the majority opinion is the unproven allegation that it would be uneconomic for Mitchell to undertake the drilling of more wells in the Boonesville Field if the gas must be sold at the area rates. For example, by comparing Mitchell's estimated outlays of $11.0 million in five years with additional revenues of $4.1 million (based on Mitchell's 59% working interest), the majority ignores between $18.0 million and $30.5 million of additional revenue that may be received at area rates beyond the first five years until 1990. (The range reflects the uncertainty over Mitchell's productive working interest in the new wells.) Thus, even on this crude basis of calculation, the additional revenues are between two and three times the cost of the additional wells.

A more meaningful basis of comparison, however, is to express the required annual outlays and anticipated annual revenues at area rates on a present value basis. This would permit us to determine whether the investment would yield a reasonable return over the life of the reserves if the gas were sold at the area rates. Unfortunately, the record in this proceeding does not contain the necessary information for a precise discounted cash flow analysis.

Because the calculation is so fundamental to the question of whether the settlement proposal should be denied or

[24] Witness Thompson projects dry hole costs of $59,800 ($55,000 cost per well plus $4,800 lease cost per well).

approved, I have attempted an approximation, piecing together the relevant data from the sketchy record before us and other data accepted by the Commission in the AR67-1 proceeding (*Other Southwest Area Rate Proceeding*). Thus, my calculation allows for the drilling and compression costs (Exh. 12) and leasehold costs (Tr. 27) and assumes royalties of 14%, production taxes of 7½%, other cash expenses of 2.645¢ per Mcf, and a net liquid credit of 3.06¢ per Mcf. The projected gas volumes from the additional drilling are based on the most conservative estimate of ultimate recovery that is in the record, specifically 127 Bcf after the first five years. On this basis, the calculation shows that Mitchell could anticipate about a 20% return on his investment if he acquires a total working interest. Perhaps his working interest will be less than 100%, but there is nothing in the record to tell us what a reasonable estimate might be. This is admittedly only a rough discounted cash flow analysis — the record permits nothing better — but it is sufficient to establish a strong presumption that there is no basis for claiming that the additional drilling would be uneconomic at the area rates. On the contrary, it could prove to be highly profitable.

In the *Panhandle* decision, Opinion No. 626, issued September 20, 1972, we authorized Panhandle's affiliate to receive the area rate for flowing gas, as opposed to cost-of-service of such gas. All excess revenues received from such authorization were required to be used for exploration and development and a specific dedication of gas reserves was required. A failure by the affiliate to achieve the goal of 400,000,000 Mcf reserve dedications in seven years would require Panhandle to refund monies to its customers. Additionally, any gas discovered was ineligible for the optional certification procedures of Order No. 455. This basic rationale and the conditions imposed in Opinion No. 626 were affirmed in our January 22, 1973 order in *Natural Gas Pipeline Co. of America*, Docket No. RP73-63, where we remand-

ed a proposal for hearing. None of the protections afforded Panhandle's customers may be found in the Mitchell proposal.

Since excess revenues are indeterminate on the record of this case, the ratepayers should, as a minimum, have received the protection of requiring all excess revenues over the area rates prescribed by the Commission to be reinvested in gas exploration and development over the five-year period and all gas wherever found to be dedicated to the interstate market.

V.

As part of the settlement, Mitchell agrees to spend $16.5 million for exploration during the five-year period in the continental United States, consisting of $9 million for the Wise County 125 wells and $7.5 million in additional exploration.[25] (It should be noted that Mitchell spent $7 million in 1972 alone on exploration. Tr. 37.) The record indicates that Natural's consumers may receive 37 Bcf at a wellhead cost of 50.39¢ per Mcf from the $9 million expenditure in Wise County.[26] The question then becomes what benefits accrue to jurisdictional consumers from the $7.5 million expenditure?

The $7.5 million commitment over a five-year period in addition to exploration outside Wise County need not be for gas exploration and development, but may be expended in a directional search for oil or gas. Furthermore, if gas is found, it need not be offered to the interstate market; much less be dedicated to serve interstate consumers. Natural

[25] The $7.5 million consists of the $3 million in revenues over cost in Wise County and $4.5 million representing the 1967-71 expenditures by Mitchell for exploration outside the Boonesville Field. This so-called commitment is not unlike my dissent in Opinion No. 619 in which I was joined by Commissioner Moody. See mimeo. at p. 8 concerning Tennessee's expansion commitment.

[26] An additional $2 million will be spent for compression.

receives a preferential right to purchase gas supplies found outside the contract area, only (1) within Texas, *and* (2) within 25 miles of Natural's facilities. If Natural fails to take the gas, then it will be offered (not dedicated) to the jurisdictional market.[27] If gas is discovered outside Texas or within Texas but more than 25 miles from Natural's facilities, then Natural has no preferential right and thus neither does the interstate market. Neither Natural's consumers, who contributed the capital in the first place, nor any other interstate consumers are entitled to any gas discovered outside the defined limits. The end result of this settlement feature may be more gas for the intrastate market at the risk and expense of interstate consumers.

The majority refers to "arms-length bargaining" between Natural and Mitchell in arriving at this agreed settlement. The salient fact is that Natural has neither the incentive to bargain for the lowest reasonable price to the consumer nor the power to do so. Natural can flow-through any increase in its purchased gas costs to its consumers. When a pipeline is in curtailment, as Natural is, that buyer has little bargaining leverage. Finally, Mitchell stands as virtually the only major producer in Texas R.R. District No. 9. Mitchell made over one-third of the sales to interstate pipelines (by producers with volumes of 2 million Mcf or more annually) from this area in 1970.[28] Mitchell acts as operator for producers making over 70% of the jurisdictional sales to pipelines in the district.[29] It is difficult to conceive of any "arms length bargaining" under these circumstances which only adds a greater responsibility to the Commission to examine the justness and reasonableness of the proposed rate.

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[27] Tr. 142-143.

[28] Sales by Producers of Natural Gas to Interstate Pipeline Companies, 1970, S-217, at pp. 368-369.

[29] 46 FPC at 1048.

CONCLUSION

I remain fully cognizant of the benefits to cash flow from increasing flowing gas rates so as to stimulate capital to conduct the necessary exploration and development effort. Consumers who contribute to increased cash flow-through higher rates must be protected by regulatory controls to channelize the product of expanded exploration and development to improve interstate gas service. Conversely, I recognize that many integrated gas producers will devote capital, either generated internally or externally, to gas exploration if it represents an attractive investment opportunity. Thus, I view new gas prices at the appropriate level in addition to just and reasonable flowing gas rates as a better method to attract capital and more efficiently allocate the resource. Having prescribed in the Other Southwest Area, rates for both flowing gas and new gas determined upon a full evidentiary record and which are currently on review by the courts,[30] it does not seem that the public interest is now served by granting the unsupported representations of a single gas producer that those rates must now be modified.

If Mitchell wishes to drill 125 wells and dedicate gas to the interstate market, or embark on other gas exploration programs for the benefit of jurisdictional consumers, he can avail himself of our optional certification procedures.[31] Mitchell would bear the risk of such program, and properly so, and the price negotiated with an interstate pipeline could be judged upon an evidentiary record.

The majority refers to Opinion No. 598, particularly portions of paragraphs 149 and 151, to support the "relationship between cash flow generated by sales of flowing gas and an expanded exploration and production effort." However, the flowing gas rate prescribed in an area rate proceeding,

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[30] *Shell Oil Co.* v. *F.P.C.*, CA5, No. 72-114.

[31] Order No. 455.

by itself, is not dispositive of the "relationship". Additional cash flow to conduct the necessary exploration and development effort is likewise generated from refund credits and contingent escalations of flowing gas prices.[32] Both these latter incentives become operative only upon the dedication of new gas reserves to the jurisdictional market. The settlement in this proceeding does not require dedications of new gas reserves to the benefit of interstate consumers as would be required under optional pricing procedures. In the event that Mitchell finds less gas than the projected 37 Bcf, there should be a refund condition to protect Natural's consumers. *Panhandle, supra.*

I believe that petitions for special relief should be granted only after an evidentiary hearing record has been developed to warrant the grant of such relief to serve the interest of interstate consumers, as well as to protect the integrity of producer investment. The problem in this case is that the producer has not chosen to disclose either here or in the *Other Southwest Proceeding* the costs of investment or return on such investment. As set forth in the *Permian* decision, producers are not obligated to dedicate gas to interstate market and the Commission cannot compel such dedication.[33] However, the determination of the price level to attract gas to the interstate market is not a unilateral determination by a gas producer or for that matter a bilateral determination by a gas producer and an interstate pipeline company, but rather, is an essential determination to be made by the Federal Power Commission — not the parties — upon all the evidence to serve the public interest.

The majority decision casts this Commission adrift from its regulatory moorings under the guise of special relief to Mitchell to improve Natural Gas Pipeline's gas supply.

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[32] See Opinion No. 598 at paragraphs 104, 156-159.

[33] *Permian, supra,* 390 U.S. at 756-57.

The majority decision is tantamount to deregulation of flowing gas prices in violation of the Natural Gas Act. Only Congress — not this Commission — has this power.

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John N. Nassikas
Chairman

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

George Mitchell & Associates) Docket No. RI73-60

OPINION NO. 649-A

OPINION AND ORDER GRANTING INTERVENTIONS AND DENYING REHEARING

Issued: June 25, 1973

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., and
Rush Moody, Jr.

George Mitchell & Associates) Docket No. RI73-60

OPINION 649-A

OPINION AND ORDER GRANTING INTERVENTIONS AND DENYING REHEARING

(Issued June 25, 1973)

MOODY, Commissioner:

On February 21, 1973, we issued Opinion 649 granting special relief through approval of an unopposed settlement agreement. We therein authorized a rate of 30.25¢/Mcf for gas produced by George Mitchell & Associates, Inc. and Mitchell Energy & Development Corp. (Mitchell), from the Boonsville Bend Field, conditioned upon Mitchell's commitment to drill 125 new wells, install compression necessary to maintain deliverability, expend an additional $7,500,000 for exploration and development in the continental United States, dedicate additional acreage to the interstate market, and extend gas purchase rights for the life of leases covering 1,200,000 acres.

Late petitions to intervene have been filed by American Public Gas Association (APGA) and Congressman Torbert H. Macdonald and Sidney R. Yates, and these parties also seek rehearing. Associated Gas Distributors (AGD)[1] seeks rehearing for the purpose of clarification.

Those seeking to intervene out of time do not allege the existence of any facts not before us at the time of decision.

[1] The members of AGD are set forth in Appendix A.

APGA asserts only that Opinion No. 649 is "highly controversial" and will "set a precedent", while Congressmen Macdonald and Yates state that their "purpose in seeking intervention . . . is to provide the Commission with an opportunity . . . to reconsider the basis and consequences of Opinion No. 649, and, should reconsideration be denied, to test the legality of that opinion through judicial review . . ." (Petition, p. 3). No reasons for late intervention are stated except that the applicants were unaware of the pendency of this proceeding until Opinion 649 was issued. We note that our order of October 3, 1972, setting this case for hearing was duly noticed in the Federal Register.[2] The interventions have apparently been filed as a predicate for judicial review and the intervenors do not seek to offer additional evidence or otherwise guide the Commission, except to argue that our action is not legally permissible.

We will permit the interventions, but require that the applicants take the record as they find it.

AGD asks that we clarify Opinion 649 to emphasize that "the essential factors supporting the settlement agreement" relate to the addition of substantial gas reserves to the interstate market, and to make clear that our references to the nature and magnitude of curtailments on Natural Gas Pipeline Company of America's (Natural) system are not essential to approval of the settlement agreement. AGD is concerned that our findings here might operate to the prejudice of AGD's position on appeal of Opinion No. 655 (Hilda B. Weinert, *et al.*, Docket No. G-2730, *et al.*).[3] AGD is correct in its assertion that the exact extent of Natural's supply shortage is not controlling here, and that findings of

[2] 37 FR 21379.

[3] Opinion issued March 21, 1973, 49 FPC , rehearing denied, Order issued April 18, 1973, 49 FPC , appeal docketed *Transcontinental Gas Pipe Line Corp.* v. *F.P.C.*, CADC, No. 73-1410, *Public Service Commission for the State of New York* v. *F.P.C.*, CADC, No. 73-1412.

specific levels of curtailment were not essential to our approval of the settlement. We discussed Natural's gas supply and procurement efforts (Opinion No. 649 at pp. 9-10) to underscore the benefits to consumers dependent on Natural which the settlement provides and to demonstrate the adverse consumer impact of a denial of the settlement. These matters were the subject to testimony in the record.

In discussing briefly the legal arguments raised by APGA, and Congressmen Macdonald and Yates, we would emphasize that Opinion 649 dealt with an agreed settlement, offered only after every party who sought hearing had been accorded the right to a full hearing. The Fifth Circuit Court of Appeals has recently reminded us:

> ". . . If there was ever an area in contemporary socio-economic problems in which the snail-like pace of a transplanted Article III Case and Controversy is inadequate, this endless struggle for solution through the proliferation of administrative orders and judiciary appeals is surely it. Ironically, while Rome burns, the gas has gone out. If — and the IF gets bigger every day — the country is to solve this problem, it has to be done by adjustment, compromise, give and take. FPC settlements are therefore to be encouraged." (*Placid Oil Company, et al.* v. *F.P.C.* No. 71-2761 [CA5, 1973], slip opinion issued April 16, 1973, at p. 20.)

Opinion 649 must be considered as an analysis of a settlement proposal, offered by a seller and a buyer, and acquiesced in by distributor customers of the buying pipeline and by our Staff. Despite this unanimity, however, the Commission did not approve the settlement without a full review of the record, and a consequent determination that the settlement was in the public interest.

After the interventions of APGA and Congressmen Macdonald and Yates were filed, two Court of Appeals decisions

have been rendered which bear upon our action on the Mitchell petition for special relief. First, in *Placid Oil Company, supra,* the Fifth Circuit looked to the Commission's overall pattern of producer regulation in reaching a decision to affirm the *Southern Louisiana* area rates prescribed in Opinions 598, 46 FPC 86 (1971). After noting the inherent difficulties of prescribing industrywide rates (slip opinion at pp. 65-67), the Court said:

> ". . . But it is a comforting reassurance to a court that has demonstrated so many times its inability to review rate determinations with infallible omniscience to know that there are alternative methods by which producers who are unable to exist in the economic clime of the area rate ceilings may get administrative consideration of the merits of their claims.
>
> . . . producers may . . . seek redress by . . . directly petitioning FPC to make a special allowance for a deviation from area ceilings as contemplated by *Permian,* see *e.g.,* George Mitchell and Associates, Op: 649, 'Opinion and Order Granting Special Relief and Terminating Proceedings', ... F.P.C. .... (February 21, 1973); . . .
>
> The presence of these alternatives should serve to alleviate any problems engendered by the area approach. They certainly provide great comfort to us in our role as a court compelled to review the area rate determinations, and furnish us with additional support for our decision today." (Slip opinion at pp. 67-68.)

The Mitchell settlement here approved involves production from the Other Southwest area. On June 8, 1973, in *Other Southwest Area Rate Case (OSWA I), Shell Oil Co., et al.* v. *F.P.C.,* No. 72-1114, *et al,* the Court of Appeals for the Fifth Circuit affirmed our Other Southwest area rate order (Opinion 607, issued October 29, 1971, ... FPC ....), and in the course of so doing said:

> "In *SoLa II,* [the *Placid Oil* opinion], Part VII, we examined several alternative channels of relief for

> a producer whose special circumstances warranted higher rates than the maximum allowed by the area rate proceeding. . . . Of course all of those special relief procedures are equally applicable here. And there is a substantial indication that they are being exploited.[22] . . .

We believe that both *Placid* and *Other Southwest I* demonstrate the Court of Appeals' acceptance of Opinion 649 as falling within the "special relief" parameters necessary to make producer regulation function effectively. It is noteworthy that in *OSWA I*, the Court interpreted its *Placid* opinion as follows:

> ". . . Also, [in *SoLa II*] *we cited and approved* various alternative methods by which producers who are uniquely aggrieved by area rate ceilings may seek special, individualized relief. . . ." (Slip opinion at pp. 29-30). (Emphasis supplied.)

While obviously the approval of the Fifth Circuit of special relief, as embodied in Opinion 649, as an adjunct of area rate regulation cannot rise to judicial enforcement of Opinion 649, it is patently clear that the Court has noted our action in this particular case, and has relied, to some degree, upon that action in reaching a decision to affirm two of our most important area rate opinions. Given this judicial guidance, the claims of illegality now asserted by the intervenors are, we believe, well answered. Nonetheless, we address three specific arguments.

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[22] George Mitchell and Associates, Op: 649, 'Opinion and order granting special relief and terminating proceedings,' F.P.C. (Feb. 21, 1973) was such a proceeding granting special relief to a producer in OSWA [Other Southwest]. The readiness of FPC to entertain such petitions and the effectiveness with which they are processed bolsters the reassurance which we expressed in *SoLa II*, Part VII [the *Placid Oil* Opinion]." (Slip opinion at p. 21).

1. *The claim that special relief can be granted only upon a showing of special costs.* Applicants claim that special relief must be premised on cost evidence which shows that the producer is in such a different cost situation than other producers in the area that special relief is necessary. The short answer to this claim is that it is incorrect. Special relief was provided for in *Permian I*, in these terms:

> "It would seem clear that where a producer who has contracted for an above-ceiling price can show that his out-of-pocket expenses in connection with the operation of a particular well are greater than the revenues under the applicable area price, he should be entitled to appropriate relief, *and there may be other circumstances where a producer as a matter of law or in the public interest would be entitled to some relief.*
>
> *We need not and cannot here specify all of the special circumstances which may serve as a basis for exceptions to the area rate.*" (Opinion 468, p. 105.) (Emphasis supplied.)

In reviewing, and affirming this approach, the Supreme Court said:

> "The Commission declared that a producer should be permitted 'appropriate relief' if it establishes that its 'out-of-pocket expenses in connection with the operation of a particular well' exceed its revenue from the well under the applicable area price. 34 F.P.C., at 226. It did not indicate which operating expenses would be pertinent for these calculations. *The Commission acknowledged that there might be other circumstances in which relief should be given,* but declined to enumerate them. . . . Finally, the Commission held that the burden would be upon the producer to establish the propriety of an exception, and that it therefore would not stay enforcement of the area rates pending disposition of individual petitions for special relief.
>
> The Court of Appeals held that these arrangements were inadequate. It found the Commission's descrip-

> tion of its intentions vague. . . . We cannot agree. It would doubtless be desirable if the Commission provided, as quickly as may be prudent, a more precise summary of its conditions for special relief, but it was not obliged to delay area regulation until such guidelines could be properly drawn. *The Commission quite reasonably believed that the terms of any exceptional relief should be developed as its experience with area regulation lengthens.* Moreover, area regulation of producer prices is avowedly still experimental in its terms and uncertain in its ultimate consequences: it is entirely possible that the Commission may later find that its area rate structure for the Permian Basin requires significant modification. We cannot now hold that, in these circumstances, the Commission's broad guarantees of special relief were inadequate or excessively imprecise." (390 U.S. at 770-772.) (Emphasis supplied.)

"Special relief" remained, but remained undefined, through area rate opinions such as Opinion No. 607 (Other Southwest)[4] where, without discussion, the Commission stated:

> "Prior to July 1, 1976, any seller seeking to charge a rate in excess of the applicable area rate . . . must file a petition for waiver . . . fully justifying the relief sought in the light of this opinion and order." (Opinion 607 at p. 40; Sec. 154.109(g). Regulations under the Natural Gas Act.)

We think it clear, therefore, that neither the Commission, nor any reviewing court, has ever limited "special relief" as applicants now claim. And we think it equally clear that it would be unsound for us to so limit the availability of special relief.[5]

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[4] FPC , October 29, 1971, affirmed OSWA I, No. 72-1114, *et al.*, 5th Circuit Court of Appeals, slip opinion issued June 8, 1973.

[5] *Cf. Placid Oil Co.* v. *F.P.C.*, *supra*; OSWA I, *supra*.

As found in Opinion 649, special relief here is essential if consumers are to be protected in their supply of gas from the Boonesville Bend Field. We could deny relief, as the applicants urge, but this will only guarantee less gas, at a higher price, for the consumers we are bound to protect. No applicant suggests how, in the light of this record, Natural's gas supply from the Mitchell source can be maintained if relief is denied; indeed we find the petitions for rehearing silent as to the consumer impact of denial of the relief sought here. We are not free to ignore the consequences of higher prices, and a lesser supply, which will result if the petition for relief is denied, and accordingly, we reaffirm our findings that the settlement proposed here is in the public interest and should be implemented.

2. *The claim that Opinion 649 is an attempt at deregulation of producer prices.* The applications reflect a tendency to regard as "deregulation" a regulatory action or conclusion which is unacceptable to the applicants. There is no merit, of course, to a description of Opinion 649 as "deregulating flowing gas prices" when the producer who seeks rate relief has been compelled to file a petition, present evidence in support thereof at a public hearing, file briefs, sustain a burden of proof that a different rate is just and reasonable, and secure an affirmative Commission order prior to making any rate change. It is without meaning to speak of "deregulation" in describing an order which prescribes rates, requires capital commitment in excess of $18 million as a condition of special relief approval, and requires annual reports.

We reject, therefore, the asserted claim of illegality.

3. *The claim that costs have been ignored, and Mitchell has been guaranteed a windfall profit.* The applications reflect a misunderstanding of the record. The approved settlement agreement is premised upon a cost base to

Mitchell in the range found in Opinion 607 for the Other Southwest Area wherein the Commission set an 18.7¢/Mcf rate for old gas and a 24¢/Mcf rate for new gas. Opinion 649 then considered the agreed-upon differential of 11.39¢/Mcf as the source of capital necessary to fund (1) the drilling of 125 wells at an estimated cost of $8,975,000, (2) the installation of additional compression at an estimated cost of $2,000,000, and (3) the commitment of $7,500,000 to exploration and development in the continental United States. Opinion 649 found it to be in the public interest to permit the contractually authorized increase because, on this record, it was clear that Mitchell was agreeing to the risk of $18,496,847 over five years in exploration, development, and production funds in return for a rate increase which generated $7,733,810 over the same time span. If Mitchell's program is successful, it might realize $3,000,000 in excess of area rate revenues, but if unsuccessful, it might lose $11,000,000. We afforded Mitchell no protection against the down side risk, but at the same time we required a $3,000,000 investment (over and above Mitchell's normal investment level) in domestic exploration and development, *even if Mitchell sustains a loss on the Boonesville Bend project.* These features of the settlement, coupled with the guarantee of an extension of the gas purchase agreement to "life of the lease", guarantee of intensified exploration of a gas prone area, and the expectation of sustained deliverability and increased reserve additions are, we believe, reflective of a proper concern for consumer protection, considering protection of supply as well as protection of rate.

Congressmen Macdonald and Yates argue that the Commission erred in approving a rate increase which results in an incremental cost of 50¢-65¢/Mcf, which is higher than the unregulated intrastate price in Texas Railroad District No. 9. This argument is made in connection with Exhibit

APPENDIX A

ASSOCIATED GAS DISTRIBUTORS

Atlanta Gas Light Company

The Berkshire Gas Company, Boston Gas Company, Bristol and Warren Gas Company, Brockton Taunton Gas Company, Cape Cod Gas Company, Commonwealth Gas Company, City of Holyoke, Massachusetts Gas and Electric Department, City of Westfield Gas and Electric Light Department, Concord Natural Gas Corporation, The Connecticut Gas Company, Connecticut Natural Gas Corporation, Fall River Gas Company, Fitchburg Gas and Electric Light Company, Gas Service, Inc., The Greenwich Gas Company, The Hartford Electric Light Company, Haverhill Gas Company, Lawrence Gas Company, Lowell Gas Company, Lynn Gas Company, Manchester Gas Company, Mystic Valley Gas Company, New Bedford Gas and Edison Light Company, The Newport Gas Light Company, Northampton Gas Light Company, North Attleboro Gas Company, Northern Utilities, Inc., North Shore Gas Company, The Pequot Gas Company, Providence Gas Company, South County Gas Company, Southern Connecticut Gas Company, Springfield Gas Light Company, and Tiverton Gas Company (jointly).

The Brooklyn Union Gas Company

Central Hudson Gas and Electric Corporation

Consolidated Edison Company of New York, Inc.

Elizabethtown Gas Company

Long Island Lighting Company

New Jersey Natural Gas Company

New York State Electric & Gas Corporation

Philadelphia Electric Company

Philadelphia Gas Works, Division of UGI Corporation

Piedmont Natural Gas Company, Inc.

Public Service Company of North Carolina

Public Service Electric and Gas Company

Rochester Gas and Electric Corporation

UGI Corporation

Washington Gas Light Company

George Mitchell & Associates Docket No. RI73-60

(Issued June 25, 1973)

NASSIKAS, Chairman, *dissenting:*

I would grant the rehearing applications filed by Congressman Torbert H. Macdonald and Congressman Sidney R. Yates and the American Public Gas Association insofar as those petitioners argue that Mitchell has not sustained its evidentiary burden under this petition for relief from area ceiling rates and that there is no record cost evidence to show why Mitchell's operations differ from other producers in the Other Southwest area. The reasons in support of this position are found in my full dissent to Opinion No. 649, mimeo. at 1-12. All conclusions of fact and of law set forth in that dissent are affirmed in this decision.

The majority, in denying rehearing, indicates that petitions for special relief need not be based upon a showing of special costs (order at 5-7). I disagree. The just and reasonable rate for flowing gas in this producing area was 18.7 cents per Mcf, as found in Opinion No. 607. The flowing gas rates prescribed therein were cost-based and were recently affirmed in full by the United States Court of Appeals for the Fifth Circuit, which stated:

> We recognized in SoLa I that market conditions might well justify FPC in adding non-cost incremental incentives to the rate structure. But the mere presence of a supply crisis does not compel FPC to wholly abandon a costing methodology as it carries out its responsibility to determine "just and reasonable" rates. • • • Administrative discretion is not tantamount to synergistic legerdemain. *Other Southwest Area Rate Case (Shell Oil Co.* v. *F.P.C.),* 5th Cir., Nos. 72-1114, *et al.,* June 8, 1973. Slip op. at 18-19.

If a rate is determined to be just and reasonable on the basis of costs, and thereafter judicially affirmed, *a fortiori,* individual departures from such a rate must be supported

by costs. The reliance by the majority on *dicta* (order at 4-5) by the Fifth Circuit in affirming area rates promulgated for the South Louisiana and Other Southwest areas cannot support the legally indefensible position of the majority in Opinion No. 649. Where an opinion is reversible error in the first instance, such *dicta* cannot be used to meet the "substantial evidence" test required for purposes of court review under the Natural Gas Act. There has been no such evidence in this case and as I indicated in my dissent to Opinion No. 649 (mimeo. at 2), I would remand this case for further cost evidence, without which the Mitchell petition for special relief cannot be granted. In absence of such remand, I would grant the relief sought by Congressman Macdonald and Congressman Yates "that the Commission enter an order vacating Opinion No. 649 and denying in all respects the relief sought by George Mitchell & Associates, Inc."

John N. Nassikas
Chairman

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 73-1715
September Term, 1974

Torbert H. Macdonald and Sidney R. Yates,
Petitioners

v.

Federal Power Commission,
Respondent

George Mitchell and Asso., Inc.
Northern Illinois Gas Company
Natural Gas Pipeline Company
American Public Gas Asso.
Intervenors

Before: Wright and MacKinnon, Circuit Judges; Jameson*, U.S. Senior District Judge for the District of Montana.

ORDER

On consideration of intervenors' (Natural Gas Pipeline Company and George Mitchell and Associates, Inc.) petitions for rehearing, it is

ORDERED by the Court that Intervenors' aforesaid petitions are denied.

For the Court:

HUGH E. CLINE
Clerk

* Sitting by designation pursuant to Title 28 U.S. Code Section 294(d).

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 73-1715
September Term, 1974

Torbert H. Macdonald and
Sidney R. Yates,

Petitioners

v.

Federal Power Commission,

Respondent

George Mitchell and Asso., Inc.
Northern Illinois Gas Company
Natural Gas Pipeline Company
American Public Gas Asso.

Intervenors

ORDER

Intervenors' (Natural Gas Pipeline Company and George Mitchell and Associates, Inc.) suggestions for rehearing *en banc* having been transmitted to the full Court and no Judge having requested a vote thereon, it is

ORDERED by the Court *en banc* that intervenors' aforesaid suggestions for rehearing *en banc* are denied.

For the Court:

HUGH E. CLINE
Clerk



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MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

GEORGE MITCHELL & ASSOCIATES, INC.,
Petitioner

v.

TORBERT H. MACDONALD & SIDNEY R. YATES,
Respondents

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Morton L. Simons
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Attorneys for Respondents

March 21, 1975

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-960

GEORGE MITCHELL & ASSOCIATES, INC.,
Petitioner

v.

TORBERT H. MACDONALD & SIDNEY R. YATES,
Respondents

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

OPINION BELOW

The opinion of the Court of Appeals is reported at 505 F.2d 355.

QUESTION PRESENTED

Whether the Court of Appeals misapprehended or grossly misapplied the substantial-evidence standard in reversing, as not supported by substantial evidence, a finding of the Federal Power Commission that allowing a seller a rate 65% in excess of the applicable just-and-reasonable area ceiling would not produce an excessive profit for the seller.

STATEMENT*

In October 1971, the Federal Power Commission, on the basis of an extensive evidentiary record, fixed just and reasonable rate ceilings for the Other Southwest Area, FPC Opinion No. 607, 46 FPC 900, affirmed sub nom. Shell Oil Co. v. F.P.C., 484 F.2d 469 (5th Cir. 1973), cert. denied sub nom. Mobil Oil Corp. v. F.P.C., 417 U.S. 973 (1974). The rate ceilings used industry-wide costs (including a fair return) as the major point of reference, and were designed to provide incentive to producers to explore for and dedicate gas to the interstate market.

In August 1972, petitioner George Mitchell & Associates filed with the Commission a request seeking "special relief" from the area ceilings; specifically, Mitchell requested that its rates under a 1954 contract covering sales from a group of Texas counties to Natural Gas Pipeline Company of America be increased from 17.625¢ to 30.25¢ per Mcf, notwithstanding that the applicable area ceiling fixed by the Other Southwest Area Opinion provided for a maximum rate for Mitchell's sales of 18.859¢ per Mcf. At no time did Mitchell present any evidence of its costs and profits at either its existing 17.625¢ rate, at the 18.859¢ area ceiling, or at the 30.25¢ rate

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* A more detailed statement of the proceedings before the Federal Power Commission is contained in Part I of the Court of Appeals' opinion (Petition for Certiorari, App. A, pp. 4-14; 505 F.2d at 357-62).

proposed; nor was any effort made to demonstrate that Mitchell's costs differed from those of other producers in the area. Rather Mitchell predicated its request for rates 65% in excess of the area ceiling on its promise that, if granted the increase, it would undertake a specified exploration program over the next five-year period.*

Although testimony by Mitchell in support of the increase and testimony by the staff of the Federal Power Commission in opposition to the increase were received into the record, the testimony was not cross-examined, and the matter was subsequently submitted to the Commission as an offer of settlement.

On February 21, 1973, the Commission issued its principal order in this case, FPC Opinion No. 649, 49 FPC 424, in which, by a two-to-one margin (there being two vacancies on the five-member Commission), it approved the proposed settlement. The essential rationale of the majority was that the above-ceiling increase on flowing gas could be justified, since if Mitchell's exploratory program were successful, the incremental cost of new supplies, while more than

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* As noted by the court below, the exploration program it proposed to undertake if granted above-ceiling rates was no more extensive than the exploration program it had previously pursued without special relief (Petition, App. A. 9 n. 22; 505 F.2d at 360 n. 22).

double the applicable just-and-reasonable ceiling for new gas, would be less than the cost of alternative unregulated gas supplies; accordingly, said the majority, consideration of Mitchell's costs and profits at its existing rate, or at the applicable ceiling rate, or at the proposed above-ceiling rate was unnecessary. Chairman Nassikas dissented.

On appeal, taken by Congressmen Torbert H. Macdonald and Sidney R. Yates,* the United States Court of Appeals for the District of Columbia Circuit (per Judges Wright, MacKinnon, and Senior District Judge Jameson) reversed, and remanded the case to the Commission to reconsider in light of a full evidentiary record. Specifically, the court found that there was an absence of substantial evidence to support the Commission's findings (Petition, App. A. 16; 505 F.2d at 363), and that the Commission's attempt to justify the above-ceiling increase by reference to unregulated prices was barred by this Court's recent opinions in Mobil** and Texaco***, and

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* Congressman Macdonald is a member of the House Committee on Interstate and Foreign Commerce, and at the time the appeal was taken was chairman of that Committee's Subcommittee on Communications and Power. Congressman Yates represents constituents served by the gas for which the rate increase was allowed.

** Mobil Oil Corp. v. F.P.C., 417 U.S. 283 (1974).

*** F.P.C. v. Texaco Inc., 417 U.S. 380 (1974).

was, in any event, "simply inconsistent with the Commission's regulatory trust" (Petition, App. A. 18; 505 F.2d at 364).

Petitions for rehearing and for rehearing en banc were filed by Mitchell and by Natural Gas Pipeline Company (both of whom had intervened in the appeal proceeding in support of the Commission's order), but not by the Federal Power Commission. On December 2, 1974, the court denied the petitions for rehearing and for rehearing en banc, and Mitchell's petition for certiorari in this Court followed.

REASONS FOR DENYING THE WRIT

I.

The finding of the Court of Appeals that the evidentiary record before the Commission did not contain substantial evidence in support of the Commission's conclusions does not present any issue warranting grant of certiorari by this Court. And the holding of the Court of Appeals that the above-ceiling rate could not be granted--without evidence whether it would generate an excessive level of profits for Mitchell, and without evidence that Mitchell's costs differed from those of other producers subject to the area ceiling--solely because the resultant cost to the purchaser was less than the cost of unregulated fuels was, as the court below noted, required by this Court's unanimous opinion issued only last term in F.P.C. v. Texaco Inc., 417 U.S. 380 at 397-401.

Petitioner's claim (Petition 9-10) that the

decision below conflicts with the decision of this Court in Permian Basin Area Rate Cases, 390 U.S. 747 (1968), depends exclusively on the out-of-context quotation of three snippets from that opinion, all the while ignoring the Court's holding, which sustained the FPC's use of a cost-based standard for fixing just-and-reasonable rates as against producer claims that market price should have been utilized. Nowhere in the lengthy Permian opinion is there any holding that the Commission can, under the Natural Gas Act, use the unregulated market price as the standard for fixing just and reasonable rates. That was the issue presented in F.P.C. v. Texaco Inc., 417 U.S. 380, and resolved adversely to Mitchell's contentions here.

Petitioner's claim (Petition 10-11) that the decision below conflicts with holdings of the Fifth Circuit cannot be supported. It is true that in two opinions issued between the date of FPC Opinion No. 649 and the date of its reversal by the court below the Fifth Circuit adverted to the provision in the Commission's regulations for special relief proceedings, citing Opinion No. 649 as an example, Placid Oil Co. v. F.P.C., 483 F.2d 880 at 913 (5th Cir. 1973); Shell Oil Co. v. F.P.C., 484 F.2d 469 at 480 n. 22 (5th Cir. 1973). However, the passing references in the two Fifth Circuit opinions are clearly not holdings; neither Opinion No. 649 nor any other special relief case has been presented to the Fifth Circuit for review, and hence there is simply no way that there could be a conflict between the decision below and any decision of the Fifth Circuit.

II.

In any event, the Commission itself has now turned its back on the Mitchell doctrine reversed by the court below. Not only has the Commission failed to seek certiorari in this Court, but by a unanimous decision issued March 11, 1975 in Amoco Production Co., F.P.C. Opinion No. 723, the Commission has rejected the rationale of Opinion No. 649 in favor of the philosophy espoused by Chairman Nassikas' dissent to the earlier opinion. Whether this change in policy is the result of this Court's intervening decision in F.P.C. v. Texaco Inc., supra, 417 U.S. 380, or whether it is the product of a change in the Commission itself* is immaterial; the fact is that Opinion No. 649 no longer represents even the Commission's view.

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* As noted supra, FPC Opinion No. 649 was adopted by a 2-1 vote, with Commissioners Moody and Brooke forming the majority, and Chairman Nassikas vigorously dissenting. During the pendency of the appeal from Opinion No. 649, Commissioners Springer and Smith have joined the Commission, and Commissioners Moody and Brooke have departed. The Amoco opinion of March 11 represents the unanimous views of Chairman Nassikas and Commissioners Springer and Smith.

CONCLUSION

The petition for a writ of certiorari fails to set forth any grounds for grant of the writ. Accordingly, the petition should be denied.

Respectfully submitted,

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March 21, 1975